TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 1

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 30, 1938

CERTIORARI GRANTED APRIL 3, 1939

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 1

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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APPEARANCES

For Taxpayer:

GEO. BOUCHARD, Esq.,
JOSEPH D. BRADY, Esq.,

For Comm'r:

DEWILL EVANS, Esq.,
E. C. ALGIRE, Esq.,
HARTFORD ALLEN, Esq.,

Docket No. 67179

WILSHIRE OIL COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1932

Jul. 28—Petition received and filed. Taxpayer notified. (Fee paid)

Jul. 29—Copy of petition served on General Counsel.

Aug. 19—Answer filed by General Counsel.

Sep. 13—Copy of answer served on taxpayer. Circuit Calendar.

1934

Mar. 30—Hearing set week of June 4, 1934 at Beverly Hills, California.

1934

Jun. 28—Hearing had before Mr. Adams on petitioner's motion for a continuance. Proceedings restored to Los Angeles Calendar. Appearance of George Bouchard, Esq., filed.

Jun. 28—Order of continuance to Los Angeles, California circuit calendar entered.

1935

Aug. 6—Hearing set week of Sept. 30, 1935 at Los Angeles, California.

Oct. 25—Hearing had before Mr. Turner, Div. 8 on merits. Petitioner moves to continue to the next circuit calendar at Los Angeles, Calif. Showing good cause — granted. Called 9/30/35.

Nov. 4—Order of continuance to the next circuit calendar for hearing at Los Angeles, California entered.

Dec. 21—Transcript of hearing of Oct. 25, 1935 filed.

1936

Mar. 27—Notice of the appearance of Joseph D. Brady as counsel for taxpayer filed.

Apr. 3—Hearing set beginning June 15, 1936 at Los Angeles, California.

Jun. 24—Hearing had before Mr. Sternhagen, Div. 10. Submitted. Motion of counsel to consolidate for hearing granted. Amended answer filed in docket 73955 on June 22, 1936. Copy served. Amendment to petition filed in both dockets. Copy served. Answer to amendment to petition filed. Copy served.

1936

Stipulation of facts and supplemental stipulation of facts filed at hearing. Petitioner's brief due August 8, 1936—respondent's brief due Sept. 8, 1936—reply Oct. 8, 1936. Called June 15, 1936.

July. 11—Transcript of hearing of June 24, 1936 filed.

Jul. 28—Brief filed by taxpayer.

Sep. 8—Reply brief filed by General Counsel.

Nov. 18—Motion for leave to file reply brief (reply brief attached) filed by taxpayer. 11/18/36 granted.

Nov. 18—Reply brief filed by taxpayer.

Nov. 19—Copy of motion and reply brief served on General Counsel. [1*]

1937

Feb. 10—Opinion rendered, J. M. Sternhagen, Div. 10. Judgment will be entered under Rule 50.

Mar. 26—Notice of settlement filed by taxpayer.

Mar. 30—Hearing set April 21, 1937 on settlement.

Mar. 30—Copy of notice of settlement and hearing date served on General Counsel.

Apr. 21—Hearing had before Mr. Sternhagen on the petitioner's computation. Case to be simultaneously covered by judgment.

Apr. 30—Decision entered, Mr. Sternhagen, Div. 10.

May 10—Transcript of hearing of April 21, 1937 filed.

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*Page numbering appearing at the foot of page of original certified Transcript of Record.

1937

Jul. 20—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by General Counsel.

Jul. 30—Proof of service filed by General Counsel.

Aug. 24—Praecipe filed with proof of service thereon.

[2]

Docket No. 73955

WILSHIRE OIL COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1933

Oct. 6—Petition received and filed. Taxpayer notified. (Fee paid)

Oct. 6—Copy of petition served on General Counsel.

Dec. 4—Answer filed by General Counsel.

Dec. 12—Copy of answer served on taxpayer.

1934

Mar. 30—Hearing set week of June 4, 1934 at Beverly Hills, Calif.

Jun. 28—Hearing had before Mr. Adams on motion of petitioner for a continuance. Proceedings restored to the circuit calendar at Los Angeles, California. Appearance of Geo. Bouchard, Esq., filed.

1934

Jun. 28—Order of continuance to the next circuit calendar at Los Angeles, California, entered.

1935

Aug. 6—Hearing set week of Sept. 30, 1935 at Los Angeles, California.

Oct. 25—Hearing had before Mr. Turner on merits. Petitioner moves to continue on next Los Angeles, California circuit calendar—showing good cause—granted. Called 9/30/35.

Nov. 4—Order of continuance on the next circuit calendar for hearing at Los Angeles, California entered.

Dec. 21—Transcript of hearing of Oct. 25, 1935 filed.

1936

Mar. 27—Notice of the appearance of Joseph D. Brady as counsel for taxpayer filed.

Apr. 3—Hearing set week of June 15, 1936 at Los Angeles, California.

Jun. 24—Hearing had before Mr. Sternhagen on merits. Submitted. Counsel moves to consolidate with docket 67179 for hearing—granted. Amended answer filed 6/22/36—copy served. Amendment to petition filed—copy served. Answer to amendment to petition filed—copy served. Stipulation and supplemental stipulation of facts filed. Petitioner's brief due 8/8/36—respondent's brief due 9/8/36. Reply due 10/8/36. Called 6/15/36.

1936

Jul. 11—Transcript of hearing of June 24, 1936 filed.

Jul. 28—Brief filed by taxpayer. (1) July 29, 1936 21 copies received. 7/29/36 copy served.

Sep. 8—Reply brief filed by General Counsel.

Nov. 18—Motion for leave to file reply brief (reply brief attached) filed by taxpayer. 11/18/36 granted.

Nov. 18—Reply brief filed by taxpayer. 11/9/36 copy served.

1937

Feb. 10—Opinion rendered, John M. Sternhagen, Div. 10. Judgment will be entered under Rule 50. [3]

Mar. 26—Notice of settlement filed by taxpayer.

Mar. 30—Hearing set April 21, 1937 on settlement.

Mar. 30—Copy of notice of settlement and notice of hearing date served on General Counsel.

Apr. 16—Motion for decision under Rule 50 filed by General Counsel. 4/17/37 copy served.

Apr. 21—Hearing had before Mr. Sternhagen on petitioner's computation. Case *to* simultaneously covered by judgment.

Apr. 30—Decision entered, Mr. Sternhagen, Div. 10.

May 10—Transcript of hearing of April 21, 1937 filed.

Jul. 20—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by General Counsel.

Jul. 30—Proof of service filed by General Counsel. (2).

Aug. 24—Praecipe filed with proof of service thereon.

United States Board of Tax Appeals
Docket No. 67179

WILSHIRE OIL COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named corporation hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:AR:E-7:RHO-60D) dated June 1, 1932, and as the basis of its proceeding alleges as follows:

(1) The petitioner is a California corporation, with its principal office located at 2455 East 27th Street, Los Angeles, California. Its completed federal income tax return for the year 1929 was filed on or about June 14, 1930 with the Collector of Internal Revenue for the Sixth Collection District of California at Los Angeles. Said return was made on the accrual basis consistently with petitioner's method of accounting.

(2) The notice of deficiency, a copy of which, with accompanying statements, is attached and made a part hereof as Exhibit A, was mailed to the petitioner under date of June 1, 1932, as the petitioner believes. Said notice was addressed to "Wilshire Oil Company, Incorporated," which is the same corporation

as "Wilshire Oil Company, Inc.," the true name of the petitioner herein.

(3) The taxes in controversy are income taxes for the calendar year 1929. The deficiency asserted is $37,211.88, of which amount $36,507.81 is in controversy. [5]

(4) The determination of the tax as set forth in said notice of deficiency is based upon the following errors:

(a) In determining the taxable net income of the petitioner for the year 1929 the respondent erred in failing to allow sufficient depreciation on the cost of additions to the petitioner's casinghead gasoline plant during 1929.

(b) In determining the taxable net income of the petitioner for the year 1929 the respondent erred in failing to allow sufficient depletion, as provided in Section 114 (b) (3) of the Revenue Act of 1928, in the following respects:

(1) In failing to include in gross income from the oil properties the entire value of the natural gasoline extracted from natural gas produced by petitioner's own properties.

(2) In failing to include in gross income from the oil properties the entire value of petitioner's share of the natural gasoline extracted from natural gas produced on properties subleased by petitioner, in which it retains an over-riding royalty interest.

(3) In failing to include in gross income from the property the entire value of that portion of

the natural gasoline extracted from natural gas owned by other oil and gas producers and treated in petitioner's casinghead gasoline plant, which portion is retained by petitioner as its share or royalty for said treatment and extraction. [6]

(4) In failing to include in gross income from the property the entire value of petitioner's share of natural gasoline extracted from natural gas produced from its fee properties; said natural gas being supplied to others for treatment and extraction and a portion of the extracted gasoline being returned to petitioner as royalty upon said gas.

(5) In improperly deducting from the gross income from the properties:

(1) The amount of expenditures incurred and paid during the year 1929 for wages, fuel, repairs, hauling, etc., in connection with the drilling of wells, building of pipe lines and development of the properties.

(2) The amount of general overhead expense incurred during the year 1929 in connection with the drilling of wells, building of pipe lines and development of said properties.

(3) The amount of depreciation sustained on the cost of tangible oil well and drilling equipment used in connection with the drilling of wells, building of pipe lines and development of said properties.

(5) The facts upon which the petitioner relies are as follows:

(a) During the year 1923, the Fellows Gasoline Company constructed a casinghead gasoline absorption plant in the Santa Fe Springs [7] Oil Field, Los Angeles County, California. Subsequently, as at December 1, 1926, petitioner acquired all of the assets —including the casinghead absorption plant—and assumed the liabilities of the said Fellows Gasoline Company.

Immediately prior to 1929, said plant consisted of two separate and complete operating systems or *units* each of which was used to extract gasoline from wet gas supplied from the properties of the petitioner and its associated companies in the Santa Fe Springs Field. The approximate capacity of the plant immediately prior to 1929 was 50,000,000 cu. ft. of wet gas, estimated to yield 50,000 gallons of natural gasoline per day. During 1928, the fifth year of operation, due to rapid decline in natural gas production of the field, the wet gas treated amounted to an average of 1,600,000 cu. ft. per day, a basis that was scarcely profitable.

A new and deeper oil sand was discovered at Santa Fe Springs in the latter half of 1928, which gave promise of an additional supply of oil and gas from the field. The petitioner accordingly constructed three additional units to said casinghead gasoline plant at a cost of $370,246.36, providing an additional capacity of approximately 75,000,000 cu. ft. per day. During 1929, the first year of operation of the enlarged

plant, the wet gas treated by the entire plant amounted to an average of only $52,000,000 cu. ft. per day as compared with a capacity of about 125,000,000 cu. ft. During June, 1932, the [8] amount of gas treated averaged approximately 14,000,000 cu. ft. per day, or not more than 11% of capacity. The useful life of the additions to said plant constructed during 1929 was estimated by petitioner to be five years. The exhaustion, wear and tear sustained at the rate of 20% per annum during the calendar year 1929 with respect to said additional construction costing $370,246.36 was $45,911.00, which amount petitioner deducted in determining taxable net income for said year 1929. Respondent in determining taxable net income for said year has disallowed the sum of $22,955.50, or one-half of the amount of the deduction claimed by petitioner.

(b) (1) During the year 1929 petitioner owned and operated several leasehold interests of oil and gas properties in the Santa Fe Springs Oil Field. All of the natural gas produced upon said properties was run to petitioner's aforementioned casinghead gasoline absorption plant at Santa Fe Springs for treatment and removal of the natural gasoline. Of the value of gasoline thus produced, approximately 1/18 was paid to the lessor as royalty under the terms of the lease, and the balance, or approximately 17/18, retained by petitioner. Petitioner, in determining the depletion allowable in accordance with Section 114 (b) (3) of the Revenue Act of 1928, has included in the gross income from the property

for the year 1929 the entire value of its 17/18 share of [9] natural gasoline as aforesaid, and has included in the deductions from gross income from the property the proportionate cost of extraction of said natural gasoline. The respondent has arbitrarily and erroneously disallowed 60%, more or less, of the value included by petitioner as aforesaid, thereby depriving petitioner of a substantial portion of the depletion deduction authorized by law.

(b) (2) Prior to 1929 petitioner subleased to the Commodore Petroleum Company two certain leasehold interests known as the Babonet and Landl Leases, petitioner retaining as royalty 50% of all oil and gas recovered by said Commodore Petroleum Company, out of which 50% petitioner remained obligated to the original lessor for the 1/6 landowner's royalty. The Commodore Petroleum Company operated the aforesaid leases during 1929. The natural gas produced from said leases was treated by the petitioner in its casinghead gasoline plant at Santa Fe Springs, California, being the same plant referred to in foregoing paragraphs hereof. Of the gasoline recovered from the natural gas thus treated, 1/18 of its value was paid to the landowner and original lessor; 1/6 of its value was paid to the Commodore Petroleum Company, the operator of the properties; and the balance or 7/9 was retained by petitioner. Petitioner, in determining the depletion allowable in accordance

with Section 114 (b) [10] (3) of the Revenue Act of 1928, has included as gross income from the property the entire value of its 7/9 share of the natural gasoline as aforesaid and included in the deduction from gross income from the property, the proportionate cost of extraction of said natural gasoline. The respondent has arbitrarily and erroneously disallowed 50%, more or less, of the value included by petitioner as aforesaid, thereby depriving petitioner of a substantial portion of the depletion deduction authorized by law.

(b) (3) Petitioner during 1929 owned and operated a casinghead gasoline plant at Santa Fe Springs, California, as stated in the foregoing paragraphs.

In addition to treating the wet gas received from the properties mentioned above, petitioner also treated wet gas recovered from the following leaseholds of its associated companies: Off Lease, owned by Bandini Petroleum Company; Baker Lease, owned by Ambassador Petroleum Company; Koontz and Eagle Leases, owned by Wilshire Annex Oil Company. In addition thereto, petitioner treated the gas recovered from properties subleased by certain of said associated companies in which said companies retained royalty interests, to-wit: Santa Fe Dome, sublease of Bandini Petroleum Company; Buckeye Union, sublease of Ambassador Petroleum Company. [11]

The petitioner retained the entire production of the casinghead gasoline extracted from said

wet gas and each month credited each associated company which supplied said wet gas with approximately 1/3 of the value of the casinghead gasoline extracted therefrom. The value of the 2/3 portion retained by the petitioner for the extraction was credited on the petitioner's books each month as operating income for the casinghead gasoline plant.

In computing the amount of statutory depletion allowable as a deduction for the year 1929, pursuant to Section 114 (b) (3) petitioner included in gross income from the property the value of petitioner's said 2/3 share of casinghead gasoline retained, or such share as was retained. In computing net income from the property for the purpose of applying the 50% limitation provided in Section 114 (b) (3) of the Revenue Act of 1928, petitioner deducted from said gross income from the property, a pro rata share of the cost of operating and maintaining said casinghead gasoline plant.

No depletion has been claimed or allowed to any of the aforementioned associated companies in respect of the 2/3 interest in said natural gasoline produced which was retained by petitioner.

Respondent in computing the amount of statutory depletion allowable as a deduction for the year 1929, has erroneously disallowed the entire amount of depletion computed by [12] the petitioner with respect to the income derived by

the petitioner from the treatment of wet gas from the properties of its associated companies.

(b) (4) During the year 1929 petitioner operated several oil and gas properties owned by it in fee in the Huntington Beach Oil Field. Prior to 1929 petitioner contracted to sell the wet gas recovered from said properties at Huntington Beach to the O. C. Fields Corporation, which corporation operated a casinghead gasoline plant in the Huntington Beach Oil Field. This contract was in effect during the year 1929. The Fields Corporation returned to petitioner each month 60% of the casinghead gasoline extracted from the wet gas recovered from petitioner's fee properties.

The value of the casinghead gasoline so returned was credited on petitioner's books each month and was included in petitioner's taxable net income for 1929. In computing the amount of statutory depletion allowable as a deduction for the year 1929, pursuant to Section 114 (b) (3) petitioner included in gross income from the properties operated by petitioner at Huntington Beach, the value of petitioner's entire share of 60% of the casinghead gasoline returned to petitioner by the Fields Corporation. Respondent in computing the amount of statutory depletion for said year, has arbitrarily and erroneously *excluded* from gross income from said [13] properties about 40%, more or less, of the value of petitioner's share of 60% returned to petitioner by the Fields Corporation, thereby depriving pe-

titioner of a substantial portion of the depletion deduction authorized by law.

(b) (5) Petitioner for the year 1929 and years prior thereto has, pursuant to authority contained in respondent's Regulations, consistently deducted from gross income in determining taxable net income all amounts incurred and expended during said years for wages, fuel, repairs, hauling, etc. However, in computing the net income from oil properties operated by the petitioner for the purpose of determining the allowable statutory depletion for the year 1929, pursuant to Section 114 (b) (3) of the Revenue Act of 1928 petitioner has excluded from the deduction from gross income from the property the following items:

(1) Expenditures of the petitioner during the year 1929 for wages, fuel, repairs, hauling, etc., in connection with the drilling of wells, building of pipe lines and development of the properties.

(2) The amount of general overhead expense incurred during the year 1929 in connection with the drilling of wells, building of pipe lines and development of the properties. [14]

(3) Depreciation sustained by petitioner upon the cost of tangible oil well equipment and drilling equipment used during and for the purpose of developing the oil properties, all of which depreciation was sustained prior to production from the properties.

The respondent in recomputing the net income from petitioner's oil properties for the said purpose of determining the amount of allowable depletion for the year 1929, has erroneously *deducted* from gross income from the properties the aforesaid sums, thereby unlawfully depriving petitioner of a substantial deduction authorized by the aforesaid Section 114 (b) (3) of the Revenue Act of 1928.

(6) Wherefore, petitioner prays that the Board may hear this proceeding, determine that the deficiency due from the petitioner for the year 1929 should not be in excess of $704.07, and grant to the petitioner such other and further relief as to the Board seems just and equitable.

WILSHIRE OIL COMPANY, INC.
By GEORGE L. MACHRIS,
President.
245 East 27th Street
Los Angeles, California [15]

State of California
County of Los Angeles—ss.

George L. Machris, being duly sworn, says he is President of Wilshire Oil Company, Inc., the petitioner named herein; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; and that the facts stated are true, except as to those facts stated to be on information and belief, and those facts he believes to be true.

GEORGE L. MACHRIS

Subscribed and sworn to before me this 26th day of July, 1932.

[Seal] PAUL A. LOWER

Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires May 22, 1933. [16]

EXHIBIT A

Treasury Department
Washington

June 1, 1932

Wilshire Oil Company, Incorporated.
2455 East 27th Street,
Los Angeles, California.

Sirs:

You are advised that the determination of your tax liability for the year (x) 1929 discloses a deficiency of $37,211.88, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the clos-

ing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By (Signed) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
Schedules 1 and 2 [17]

STATEMENT

IT:AR:E-7
RHO-60D

In re: Wilshire Oil Company, Incorporated,
2455 East 27th Street
Los Angeles, California

Tax Liability

Year—1929.
Tax Liability—$200,489.89.
Tax Assessed—$163,278.01.
Deficiency—$37,211.88.

The deficiency shown herein is based upon the report dated October 10, 1931, prepared by Revenue

Agent, P. F. Berger, and transmitted to you under date of November 24, 1931 which report is made a part hereof, and upon such adjustments as are shown in the attached schedules numbered 1 and 2.

Careful consideration has been accorded your protest dated March 16, 1932 in connection with the findings of the examining officer, and the information submitted at a conference held in the office of the internal revenue agent in charge, on April 4, 1932. The action taken by this office is fully explained in the attached schedules. [18]

Wilshire Oil Company, Incorporated.
Year ended December 31, 1929.

Schedule 1
Adjustments to Net Income

Net income as disclosed by revenue agent's report dated October 10, 1931		$1,833,309.94
As corrected		1,822,635.39
Net adjustment as computed below		$ 10,674.55
Additional income:		
(a) Surbeck sump rental	$ 857.75	
(b) Reduction of gas suit costs	500.65	
Total		$ 1,358.40
Additional deductions:		
(c) Refund 1928 compensation insurance	$3,864.43	
(d) Additional depletion	8,168.52	
Total		12,032.95
Net adjustment as above		$ 10,674.55

Schedule 1-A

Explanation of Items

(a) Surbeck sump rental $857.75, represents the accrual of amounts as rental on the Wilshire Surbeck sump determined as follows:

Wilshire Annex Oil Company	$367.61
Bandini Petroleum Company	490.14
Total added to income	$857.75

(b) Reduction of gas conservation suit costs $500.65, in connection with litigation incurred in 1929, 1930 and 1931, adjusted in accordance with final re-allocation of expenses assumed, and agreed to in conference held in office of internal revenue agent in charge, at Los Angeles, April 4, 1932. [19]

(c) Refund of compensation insurance $3,864.43, representing a proper accrual at December 31, 1928, and eliminated in computing 1929 income, allowed.

(d) Additional depletion $8,168.52, is determined as follows:

Depletion allowed	$377,785.08
Depletion deducted Exhibit "F", revenue agent's report	369,616.56
Additional depletion, allowed	$ 8,168.52

Depletion allowed is in accordance with the decision reached in conference held in the office of the internal revenue agent in charge at Los Angeles on April 4, 1932, the details of which are set forth in letter to you from internal revenue agent in charge, dated May 13, 1932, items A to E, inclusive.

Schedule 2

Computation of Tax

Income Tax

Net income for taxable year, schedule 1	$1,822,635.39
Income tax 11%	200,489.89
Total previously assessed, Account #402,905	163,278.01
Deficiency	$ 37,211.88

[Endorsed]: U.S.B.T.A. Filed July 28, 1932.

[20]

[Title of Court and Cause—Docket No. 67179.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations of paragraph (1) of the petition.

(2) Admits the allegations of paragraph (2) of the petition.

(3) Admits the taxes in controversy are income taxes for the calendar year 1929.

(4) Denies the respondent erred in the determination of the deficiency as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition, and subdivisions thereunder.

(5) For lack of information upon which to form a belief as to the truth or falsity of said allegations, denies the material allegations of fact contained in subparagraphs (a) and (b) of paragraph (5) of the petition, and subdivisions thereunder.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
HENRY A. COX,
T. A. DILS,
Special Attorneys,
Bureau of Internal Revenue

[Endorsed]: U.S.B.T.A. Filed August 19, 1932.

[21]

[Title of Court and Cause—Docket No. 67179.]

AMENDMENT TO PETITION

Paragraph (4) of the petition is amended to read as follows:

(4) The determination of the tax set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erred in computing the amount of percentage depletion to which petitioner was entitled with respect to the oil and gas wells on its Peterson, Baker and Crawford properties in that in determining the net income from each of said properties respondent erroneously deducted from gross income from the property the following items, among others: (1) amounts expended for wages, fuel, repairs, hauling, etc.,

in connection with the exploration of the property, drilling of oil and gas wells thereon, and development thereof; (2) depreciation during the drilling period on equipment used in drilling the wells referred to in item 1; (3) depreciation of equipment used for the production of oil. [22]

(b) Respondent erred in failing to allow a depreciation deduction in the amount of $44,065.56 for depreciation sustained on petitioner's natural gas plant used in petitioner's business during the taxable year 1929.

JOSEPH D. BRADY,
Counsel for Petitioner
458 South Spring Street,
Los Angeles, California.

[Endorsed]: U.S.B.T.A. Filed at hearing June 24, 1936.

[23]

[Title of Court and Cause—Docket No. 67179.]

ANSWER TO AMENDMENT TO PETITION

NOW comes the respondent, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the amendment to the petition in the above-entitled proceeding denies as follows:

4(a) and (b). Denies the allegations of paragraphs 4(a) and (b) of the Amendment to the Petition.

Wherefore it is prayed that the petition as amended be denied.

(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
HARTFORD ALLEN,
Special Attorney,
Bureau of Internal Revenue.
A/nw

[Endorsed]: U.S.B.T.A. Filed at hearing June 24, 1936.

[24]

[Title of Court and Cause—Docket No. 73955.]

PETITION

The above named corporation hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:AR:E-7:RHO-60D) dated August 10, 1933, and as a basis of its proceedings alleges as follows:

(1) The petitioner is a California corporation with its principal office at 2455 East 27th Street, Los Angeles, California. Its completed federal income tax return for the year 1930 was filed on or about June 12, 1931 with the Collector of Internal Revenue for the Sixth Collection District of California at Los

Angeles. Said return was made on the accrual basis consistent with petitioner's method of accounting.

(2) The notice of deficiency, a copy of which, with accompanying statements, is attached and made a part hereof as Exhibit A, was mailed to the petitioner on August 10, 1933. Said notice was addressed to "Wilshire Oil Company, Incorporated," which is the same corporation as "Wilshire Oil Company, Inc.," the true name of the petitioner herein.

(3) The taxes in controversy are income taxes for the calendar year 1930. The deficiency asserted is $51,144.64, of which the sum of $50,145.22 is in controversy.

(4) The determination of tax set forth in said notice of deficiency [25] is based upon the following errors:

(a) The failure of the Commissioner to allow as a deduction from gross income in the year 1930, depreciation at the rate of twenty (20) per cent per annum upon the cost of petitioner's casinghead gas plants constructed during the year 1929.

(b) The failure of the Commissioner to allow as a deduction from gross income in the year 1930, depreciation at the rate of ten (10) per cent per annum upon the cost of petitioner's oil storage tanks.

(c) The failure of the Commissioner to allow as a deduction from gross income in the year 1930, sufficient percentage depletion as provided by statute on proceeds of production of oil and

gas wells in which petitioner had a depletable interest.

(5) The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner and/or its affiliated subsidiary constructed during the years 1923 to 1929, inclusive, five casinghead gas plants on the Surbeck lease in the Santa Fe Springs Oil Field, Los Angeles County, California. Three of said five casinghead gas plants were constructed in 1923 at a cost including gathering pipe lines, etc., of approximately $757,937.84. Petitioner during 1929 constructed two new casinghead gas plants alongside the old plants on the Surbeck property at a cost of $428,553.20. [26]

Petitioner and its subsidiary companies acquired prior to 1923 a number of prospective oil properties through leases in the Santa Fe Springs Oil Field. Said properties were potentially productive of oil and gas in large quantities from the upper oil sands then known. In the latter half of 1928 petitioner discovered a new and deeper oil sand at the Santa Fe Springs Oil Field which gave promise of an additional prolific supply of oil and gas. The casinghead gas plants constructed in 1923 and those constructed in 1929 were planned with a view to having sufficient capacity to handle and treat the anticipated volume of wet gas produced during the flush period of production from the oil and

gas wells of the petitioner and its subsidiary companies. Due to an insufficient supply of casinghead gas only one of the three plants constructed in 1923 was operated continuously from 1923 to 1929. During the first half of 1928, the fifth year of operation, the casinghead gas treated by petitioner's plants amounted to an average of 1,600,000 cu. ft. per day, or about 1.7 per cent of the guaranteed capacity of the original three plants and far less than the capacity of the one plant operated.

The maximum capacity of petitioner's plants constructed in 1929 was approximately 75,000,000 cu. ft. of wet gas per day. The casinghead gas treated during 1929 by both old and new plants amounted to an average of approximately 52,000,000 cu. ft. per day. At the present time (September, 1933) the amount of gas treated daily averages about [27] 8,000,000 cu. ft. or about one-third of the nominal capacity of one of the new plants. The old plants have not been operated since 1930.

At the close of 1929, petitioner, basing its judgment on its familiarity and experience with the useful life of this class of equipment estimated that the normal useful life and the economic term of usefulness of said new plants would practically terminate within a period of five years. The reasonable depreciation in value of the casinghead gas plants constructed by the petitioner in 1929 was at the rate of 20 per cent of its cost

of $428,553.20. In computing taxable net income for the year 1930, petitioner deducted from income the sum of $84,421.00, representing depreciation at the rate of 20 per cent per annum upon the cost of petitioner's casinghead gas plants constructed during the year 1929.

Respondent allowed as a deduction from income for the year 1930, the sum of $42,210.50 for the depreciation upon the cost of petitioner's casinghead gas plants constructed during 1929. This allowance was at the rate of 10 per cent per year on cost.

(b) Petitioner during the years 1922 to 1930, inclusive, constructed large steel tanks for the purpose of storing its surplus crude oil and the refined and by-products obtained therefrom. The storage tanks first constructed were located at or near petitioner's refinery at Vernon, California. [28]

A description of the Vernon storage tanks follows:

Tank No.	Acquired	Construction	Capacity Bbls	Cost
1-7 (Run Down)	1922	Steel	3,000 each	$ 18,867.37
41 " "	1923	"	80,000	30,613.76
42 " "	1923	"	80,000	29,941.53
33	1922	"	6,000	6,126.04
34	1922	"	10,000	7,361.59
35	1922	"	10,000	7,243.67
36	1923	"	10,000	7,271.77
37	1923	"	10,000	7,712.63
38	1923	"	10,000	7,407.01
39	1923	"	10,000	7,363.48
40	1922	"	80,000	35,329.41
43	1923	"	80,000	35,456.13
44	1923	"	80,000	35,550.44
45	1923	"	80,000	35,405.22
46	1926	"	80,000	26,223.49
47	1926	"	80,000	26,163.99
48	1926	"	10,000	5,554.96
49	1926	"	10,000	5,608.43
50	1926	"	10,000	5,586.95
51	1928	"	80,000	28,120.08
52	1928	"	80,000	28,120.09
Miscellaneous	1923	"	0	2,471.19
TOTAL VALUE OF VERNON TANKS				$399,499.23

The first nine tanks above listed are used as "run down tanks." They are continuously used as such due to the injurious chemical contents of the untreated product. The remainder of the tanks are used to store crude oil, finished gasoline, and the by-products of kerosene distillate and fuel oil.

Petitioner discovered a new and deeper oil sand at the Santa Fe Springs Oil Field in the latter half of 1928. Additional storage tanks were immediately contracted for, and were constructed during 1929 and 1930 on petitioner's fee property at Norwalk, California. The capacity of the Norwalk storage [29] tanks amounted to ap-

proximately 6,400,000 barrels, comprising 32 tanks of a capacity of 130,000 barrels each and 14 tanks of a capacity of 164,000 barrels each. The cost of said Norwalk tanks aggregated $2,470,005.43, of which $1,542,106.45 was expended during 1929 and $927,898.98 was expended during 1930.

Steel tanks in finished gasoline service require no attention from the corrosion point of view. In the case of crude, rundown and other services the roof suffers most severely; the bottom next, and the sides least. The tank bottoms suffer from the water (and the impurities it contains) that usually accompanies the oil; in the case of crude oil, salt water containing hydrogen sulfide; in distillates, hydrochlorine acid as well as hydrogen sulfide; and in re-run distillates from acid-treated stocks, sulphur dioxide.

Subsequent to the time petitioner contracted for the Norwalk tankage and prior to the close of the taxable year 1930 State laws having the effect of curtailing the production of crude oil became effective. The volume of crude oil for which petitioner primarily constructed its Norwalk tanks declined at an abnormally high rate during the taxable year 1930. The useful life of petitioner's storage tanks under such conditions did not exceed ten years. The reasonable depreciation in value of the petitioner's Vernon and Norwalk storage tanks was at the rate of 10 per cent of their cost. [30] In computing taxable

net income for the year 1930, petitioner deducted from the income the sums of $39,705.64 and $220,956.53, representing depreciation during the year 1930 at the rate of 10 per cent per annum upon the cost of petitioner's oil storage tanks at Vernon and Norwalk, California, respectively. Respondent allowed as a deduction from income for the year 1930, the sums of $19,974.96 and $110,478.27, for the depreciation upon the cost of petitioner's oil storage tanks at Vernon and Norwalk, California. This allowance was at the rate of 5 per cent per year on cost.

(c) (1) Respondent in determining the "net income of the taxpayer (computed without allowance for depletion) from the property" for the purpose of determining the percentage depletion deduction, erroneously included the following items as deductions:

(a) The state corporation franchise tax in the amount of $6,151.11.

(b) Development expenses in the amount of $351,027.87.

(c) Depreciation on development equipment in the amount of $124,341.98.

(2) Respondent, in computing the gross income from oil and gas wells operated by petitioner during 1930 in the Santa Fe Springs Oil Field for the purpose of determining the percentage depletion deduction, erroneously failed to include in said gross income 60% of the value

of casinghead gasoline recovered from casinghead gas taken from said oil and gas wells. [31]

(3) Respondent in determining the percentage depletion deduction in respect of gross income derived by petitioner in connection with casinghead gas taken from oil and gas wells under contracts commonly called casinghead gas contracts, erroneously failed to include as gross income the value of petitioner's share of casinghead gasoline derived from casinghead gas taken from said oil and gas wells under contract.

With respect to the deduction of state franchise tax in determining petitioner's net income from the property the facts are as follows:

During the year 1930, petitioner paid to the State of California a corporation franchise tax computed upon the basis of petitioner's net income for the preceding calendar year. The amount of tax so paid was $20,503.70, of which the sum of $6,151.11 was apportioned by respondent to the production of oil. Respondent included said amount of $6,151.11 in his deductions from gross income from petitioner's properties, thereby decreasing net income from the properties and the percentage depletion allowable.

The state franchise tax was paid by petitioner for the privilege of exercising its corporate franchise during the year 1930. The expenditure had no relation to the kind of business conducted and was not an expenditure "in respect to the property upon which depletion was claimed." [32]

With respect to the deduction of development expenses in the amount of $351,027.87 hereinbefore stated, petitioner pursuant to respondent's Regulations in force for the taxable year 1930, elected to treat development expenditures as ordinary and necessary business expenses deductible under section 23 (a), Revenue Act of 1928, in computing taxable net income. Said development expenses were incurred in connection with the drilling of petitioner's oil and gas wells in the Santa Fe Springs Oil Field and for repairs to drilling outfits, derricks, well machinery and tools, boilers, pipelines etc., used in the development of said oil and gas wells. All of said development expenses were incurred by petitioner prior to any production of oil or gas from said wells.

With respect to the depreciation deduction hereinbefore stated, petitioner sustained depreciation in the amount of $124,341.98 upon the cost of tangible oil well equipment and drilling equipment used during and for the purpose of developing the oil and gas wells in the Santa Fe Springs Oil Field. All of said depreciation was sustained prior to any production of oil or gas from said oil and gas wells. In computing the net income from petitioner's oil and gas properties for the purpose of determining the percentage depletion deduction for the year 1930, pursuant to section 114 (b) (3), Revenue Act of 1928, petitioner has excluded as a deduction

from gross income from the [33] property the aforesaid sums of $6,151.11, $351,027.87 and $124,341.98. Respondent in computing the net income from petitioner's oil and gas wells for the said purpose of determining the amount of the percentage depletion deduction for the year 1930, erroneously deducted from gross income from the property the aforesaid sums of $6,151.11, $351,027.87 and $124,341.98.

With respect to respondent's failure to include as gross income from the oil and gas wells operated by petitioner in the Santa Fe Springs Oil Field sixty (60) per cent of the value of casinghead gasoline recovered from casinghead gas taken from said oil and gas wells, the facts are as follows:

Petitioner owns and operates casinghead gasoline plants adjacent to the Santa Fe Springs Oil Field. Petitioner acquired prior to the year in question certain oil and gas properties through leases in said oil field. The properties were developed by petitioner and the oil and gas wells drilled thereon supplied petitioner's casinghead gas plants with casinghead gas.

The casinghead gas plants separated and liquefied the natural gasoline contained in the casinghead gas. The remaining or dry gas was sold, used for fuel, or returned to the wells. Petitioner credited to its Santa Fe Springs producing properties for depletion purposes the value of the natural or casinghead gasoline recovered during

1930 from the casinghead gas taken from [34] petitioner's oil and gas wells in the Santa Fe Springs Field. In determining the gross income from said properties for depletion purposes petitioner deducted from the sum so credited to the property, the value of the lessor's share of casinghead gasoline.

Respondent in respect of gross income derived by petitioner from said casinghead gas allowed as gross income for depletion purposes from petitioner's said properties, 40 per cent of the value of petitioner's share of casinghead gasoline recovered.

With respect to respondent's failure to include as gross income for depletion purposes the value of petitioner's share of casinghead gasoline derived from casinghead gas taken from oil and gas wells under contract, the facts are as follows:

Petitioner acquired several prospective oil properties in the Santa Fe Springs Oil Field during the period 1920 to 1923. Petitioner organized several producing companies and exchanged certain of its oil properties for stock and controlling interest of said companies, herein referred to for convenience as "subsidiary companies".

Petitioner constructed casinghead gas plants adjacent to said oil field and contracted with each of its subsidiary companies for the taking and separating of the natural or casinghead gas-

oline from the casinghead gas [35] produced from oil and gas wells of the subsidiary companies. During 1923 to 1930, inclusive, petitioner was taking casinghead gas, under said contracts, from certain oil and gas wells of its subsidiary companies and treating the gas in its conversion plants to separate the gasoline from it.

After said wells had ceased flowing in commercial quantities from the natural pressure, it was necessary for petitioner to take direct means by the introduction of high pressure dry gas into said wells to induce a larger flow of oil and gas. Petitioner, by its compressors, also created a vacuum within its wet gas lines attached to the wells and thereby produced in cooperation with the operator of the well oil and gas in larger quantities. Petitioner, by virtue of said contracts, obtained the right to enter upon the property of its subsidiary companies, erect and maintain equipment thereon, attach its equipment to the casinghead of the well, and exert forces which would bring the oil and gas up out of the ground. Petitioner shared in the casinghead gas produced from said properties to the extent of 66-2/3 per cent, more or less, of the casinghead gasoline separated and recovered by petitioner's plant. In determining the petitioner's gross income for depletion purposes from properties of its subsidiary companies petitioner treated as gross income 66-2/3%, more or [36] less, of the value of the casinghead gasoline

separated and recovered by petitioner from the casinghead gas taken from said oil and gas wells.

Respondent in respect of income derived by petitioner in connection with casinghead gas taken from oil and gas wells under contract allowed to the petitioner for the year 1930 no depletion.

Respondent has unlawfully deprived petitioner of a substantial deduction authorized by section 114(b) (3), Revenue Act of 1928.

(6) Wherefore, petitioner prays that the Board may hear this proceeding, determine that the deficiency due from the petitioner for the year 1930 should not be in excess of $999.42 and grant to the petitioner such other and further relief as to the Board seems just and equitable.

WILSHIRE OIL COMPANY, INC.
By George L. Machris, President.
2455 East 27th Street
Los Angeles, California

[37]

State of California
County of Los Angeles—ss.

George L. Machris, being duly sworn, says he is President of Wilshire Oil Company, Inc., the petitioner named herein; that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein; and that the facts stated are true,

except as to those facts stated to be on information and belief, and those facts he believes to be true.

GEORGE L. MACHRIS.

Subscribed and sworn to before me this 4th day of October, 1933.

[Seal] PAUL A. LOWER

Notary Public in and for the County of Los Angeles, State of California

My Commission Expires May 22, 1937 [38]

Treasury Department
Washington

August 10, 1933

Wilshire Oil Company, Incorporated,
2455 East 27th Street,
Los Angeles, California

Sirs:

You are advised that the determination of your income tax liability for the year 1930, discloses a deficiency of $51,144.64 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of the deficiency.

However, if you do not desire to petition, you are requested to execute the enclosed form and forward

it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier; whereas if this form is not filed, interest at the rate of 6% per annum will accumulate.

Respectfully,
GUY T. HELVERING,
Commissioner.
By (Signed) CHAS. T. RUSSELL
Deputy Commissioner.

Enclosures:
Statement
Form 870
Schedules 1 and 2

[39]

STATEMENT

1T:AR:E-7
RHO-60D

In re: Wilshire Oil Company, Incorporated,
2455 East 27th Street,
Los Angeles, California.

Income Tax Liability

Year—1930
Income Tax Liability—$134,651.45
Income Tax Assessed—$83,506.81
Deficiency—$51,144.64

The deficiency shown herein is based upon the report dated September 13, 1932, prepared by Revenue Agent W. F. Upson and transmitted to you under date of October 6, 1932, which report is made a part hereof, and upon such adjustments as are shown in the attached schedules numbered 1 and 2.

Careful consideration has been accorded your protest dated February 28, 1933, filed with the internal revenue agent in charge, Los Angeles, against office letter of January 30, 1933, approving revenue agent's report dated September 13, 1932, in connection with the findings of the examining officer, and the information submitted at a conference held in the office of the internal revenue agent in charge, on March 17, 1933.

A consent which will expire June 30, 1934, except as extended by the provisions of section 277 of the Revenue Act of 1928, is on file for the year 1930.

A preliminary notice of this determination was mailed you June 17, 1933, against which you have not filed a protest. [40]

Wilshire Oil Company, Incorporated. Year ended December 31, 1930.

SCHEDULE 1

Adjustments to Net Income

Net income as disclosed by revenue agent's report dated September 13, 1932		$1,103,645.71
As corrected		1,122,095.44
Adjustment excessive depreciation		$ 18,449.73

Explanation of Items

Excessive depreciation $18,449.73, is determined as follows:

Depreciation deducted, refinery (various assets)	$91,715.87	
Depreciation deducted, export (building and fixtures)	764.04	
Depreciation deducted, distributing plant	406.56	$92,886.47
Depreciation allowed, refinery (various assets)	$71,985.19	
Depreciation allowed, export (building and fixtures)	382.01	
Depreciation allowed, distributing plant (building and fixtures)	2,069.54	74,436.74
Total disallowed		$18,449.73

Depreciation allowed on Refinery—Assets, is computed as follows:

Asset	Cost	Additions & Deductions	Total Cost	Rate Allowed	Depreciation Allowable
Office Building & Fixtures	$ 4,213.82	$	$ 4,213.82	10	$ 421.32
Pump House	674.78	1,390.00	2,064.78	10	79.02
Foamite Building	3,374.19		3,374.19	10	337.44
Condensing Apparatus	223,732.03		223,73[illegible]3	10	21,661.44
Steam System	40,863.43	19,425.69	60,289.12	10	4,746.80
Treating Apparatus	29,428.46	(982.42)	28,446.04	10	2,760.21
Cooling Towers	15,897.95		15,897.95	10	1,589.76
Loading Racks	5,162.81	162.96	5,325.77	10	521.68
Dykes	14,810.47		14,810.47	10	1,481.04
Oil Pipe Line	72,468.79	4,290.33	76,759.12	10	7,413.44
Pumps	36,440.36	9,878.51	46,318.87	10	4,014.56
Foamite Machinery	6,507.58		6,507.58	10	650.76
Foamite Tanks	11,030.03		11,030.03	10	1,103.04
Foamite Pipe Lines	39,288.38		39,288.38	10	3,928.68
Foamite Extinguishers	7,162.69		7,162.69	10	716.28
Water Wells	5,847.22		5,847.22	10	584.76
Tanks	399,499.23		399,499.23	5	19,974.96
					[41]
Export: Building and Fixtures	7,640.27		7,640.27	5	382.01
Distributing Plant Fixtures	41,390.69		41,390.69	5	2,069.54
Total allowed					$74,436.74

*Refinery assets: In cases above where the depreciation is not full 10% of the asset cost, provision has been made for a remaining salvage value or the balance in the account ten years prior has been dropped.

SCHEDULE 2

Computation of Tax

Income Tax

Net income for taxable year, schedule 1	$1,122,095.44
Income 12%	$ 134,651.45
Total previously assessed, account #402212	83,506.81
Deficiency	$ 51,144.64

[Endorsed]: U.S.B.T.A. Filed Oct. 6, 1933. [42]

[Title of Court and Cause.—Docket No. 73955.]

ANSWER

The Commissioner of Internal Revenue by his Attorney E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, for answer to the Petition filed by the above-named petitioner, admits and denies as follows:

(1), (2), and (3). Admits the allegations contained in paragraphs (1), (2) and (3) of the Petition.

(4). Denies the errors alleged in paragraph (4) of the Petition.

(5). Denies the averments contained in sub-paragraph (a) except the last sub-paragraph thereof; for lack of information upon which to form a belief, denies the averments contained in sub-paragraph (b) except the statement as to the total value of Vernon tanks on page 5 and the averments contained in the first full paragraph on page 6, and the last paragraph at the top of page 7, which averments are admitted; denies the errors alleged in paragraphs (1), (2), and (3) of sub-paragraph (c); admits the averments con-

tained in said sub-paragraph with respect to the amount of corporation franchise tax paid to the State of California in the last paragraphs on page 8, which averments are admitted where not inconsistent with the respondent's determination; for lack of information upon which to form a belief, denies the averments contained on pages 9, 10, 11, and 12, where inconsistent with the determination of the respondent.

[43]

Denies generally and specifically each and every allegation of fact not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) E. BARRETT PRETTYMAN
General Counsel;
Bureau of Internal Revenue.

Of Counsel:
WILLIS R. LANSFORD,
Special Attorney,
Bureau of Internal Revenue.
:wrl/tls 11-29-33.

[Endorsed]: U.S.B.T.A. Filed Dec. 4, 1933. [44]

[Title of Court and Cause—Docket No. 73955]

AMENDED ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for amended answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits that the petitioner is a California Corporation having its principal office at Los Angeles, California; denies the remaining allegations of Paragraph 1 of the petition.

2. Admits the allegations of Paragraph 2 of the petition.

3. Alleges that the notice of deficiency dated August 10, 1933, sets forth a deficiency in income taxes for the calendar year 1930 in the amount of $51,144.64.

4(a),(b),(c). Denies the allegations of Paragraph 4(a),(b),(c) of the petition.

5. Denies the allegations of Paragraph 5(a),(b),(c) of the petition. [45]

6. Denies generally and specifically each and every allegation not hereinbefore admitted or denied.

Wherefore it is prayed that the appeal be denied.

(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
HARTFORD ALLEN,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed at hearing June 22, 1936. [46]

[Title of Court and Cause—Docket No. 73955.]

AMENDMENT TO PETITION

Paragraph (4) of the petition is amended to read as follows:

(4) The determination of the tax set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erred in computing the amount of percentage depletion to which petitioner was entitled with respect to the oil and gas wells on its Peterson, Baker, Crawford and Buckbee properties in that in determining the net income from each of said properties respondent erroneously deducted from gross income from the property the following items, among others: (1) amounts expended for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of oil and gas wells thereon, and development thereof; (2) depreciation during the drilling period on equipment used in drilling the wells referred to in item 1; (3) depreciation of equipment used for the production of oil. [47]

(b) Respondent erred in failing to allow a depreciation deduction in the amount of $16,386.71 for depreciation sustained on petitioner's natural gas plant used in petitioner's business during the taxable year 1930.

(c) Respondent erred in failing to allow a depreciation deduction in the amount of $110,478.27 for depreciation sustained on peti-

tioner's storage tanks used in its business during the taxable year 1930.

JOSEPH D. BRADY
Counsel for Petitioner
458 South Spring Street
Los Angeles, California

[Endorsed]: U.S.B.T.A. Filed at hearing June 24, 1936. [48]

[Title of Court and Cause—Docket No. 73955.]

ANSWER TO AMENDMENT TO PETITION

Now comes the respondent, by his attorney, Herman Oliphant, General Counsel for the Department of the Treasury, and for answer to the amendment to the petition in the above entitled proceeding denies as follows:

4(a), (b), and (c). Denies the allegations of paragraphs 4(a), (b), and (c) of the Amendment to the Petition.

Wherefore it is prayed that the petition as amended be denied.

(Signed) HERMAN OLIPHANT
General Counsel for the
Department of the Treasury.

Of Counsel:
HARTFORD ALLEN,
Special Attorney,
Bureau of Internal Revenue.
HA/nw

[Endorsed]: U.S.B.T.A. Filed at hearing June 24, 1936. [49]

[Title of Court and Cause—Docket Nos. 67179 and 73955]

STIPULATION OF AGREED FACTS

It is hereby stipulated and agreed, by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true.

I.

The petitioner is, and at all times material to this proceeding was, a California corporation, with principal office and place of business at Los Angeles, California, engaged in the business of producing oil and gas from various properties located in Southern California.

II.

During the taxable years 1929 and 1930, petitioner was not affiliated with any other corporation and the returns which it filed with the Collector of Internal Revenue at Los Angeles for said years were returns of its own income and were not consolidated returns.

III.

The controversy between the parties hereto concerns the [50] amount of the deductions for depletion of oil and gas wells for the taxable years 1929 and 1930 allowable under Section 114(b)(3) of the Revenue Act of 1928.

During the taxable years petitioner operated six oil and gas properties at Huntington Beach, California, which it owned in fee; it also operated, as

lessee, five properties located in the Santa Fe Springs Oil Field.

In addition to these eleven properties, which it operated, petitioner also derived royalty income during the taxable years from four oil and gas properties which it had subleased to others prior to the taxable years.

In determining the deficiency for 1929, respondent allowed petitioner a depletion deduction for all fifteen of its oil and gas properties in the amount of $377,785.08. $71,535.08 of said amount relates to the four properties which were under sub-leases, and there is no controversy with respect thereto.

Respondent determined that petitioner sustained losses during the taxable year 1929 from the operation of four of its properties, as follows:

Property	Loss
Buckbee Lease	$111,299.00
Huntington Beach No. 5	14,629.63
Huntington Beach No. 7	13,779.16
Huntington Beach No. 12	14,090.56
Total	$153,798.35

The gross income from the Buckbee lease was $4,600.11, but respondent allowed no depletion deduction with respect thereto. Petitioner takes no exception to respondent's determination [51] in this respect, inasmuch as petitioner concedes that it sustained a loss from the operation of the Buckbee lease in the taxable year.

As to the Huntington Beach properties Nos. 5, 7, and 12, respondent allowed depletion deductions, on the cost basis, aggregating $50.60; and petitioner raises no issue with respect to these properties, or as to its other three Huntington Beach properties or as to its Cecelia lease at Santa Fe Springs.

The controversy as to the year 1929, therefore, is narrowed to the following three properties, to-wit, the Peterson, Baker and Crawford Leases in Santa Fe Springs; for 1930, the controversy concerns these three properties and petitioner's Buckbee lease.

The attached schedule, marked Schedule "A" and made a part hereof by reference, shows, for both taxable years, the undisputed gross income from each property; the net income from each property (computed without allowance for depletion) as determined by respondent; the depletion deduction as determined by respondent for each property in computing the deficiencies; and three items of deductions from gross income from the property—the deductibility of which petitioner puts in questions—marked Items numbered 1, 2 and 3. [52]

IV.

Petitioner concedes that in determining the deficiency for 1930 respondent erroneously failed to disallow a deduction of $43,733.44 erroneously taken by petitioner in its return for said year as officers' salaries, and that the statutory net income, as redetermined by the Board may reflect an adjustment with respect thereto.

Respondent concedes that petitioner is entitled to additional depreciation deductions, not allowed in determining the deficiencies, as follows:

1929	
On Natural Gas Plant	$ 44,065.56
1930	
On Natural Gas Plant	$ 16,386.71
On Storage Tanks	110,478.27

It is agreed that the pleadings of the parties hereto shall be deemed to have been amended so as adequately to raise the adjustments referred to in this paragraph IV.

JOSEPH D. BRADY
Counsel for Respondent
(S) HERMAN OLIPHANT
Counsel for Petitioner

[53]

	1929			1930			
	Peterson Property	Baker Property	Crawford Property	Peterson Property	Baker Property	Buckbee Property	Crawford Property
Gross Income from Property	$371,561.88	$406,935.24	$222,878.05	$193,547.12	$ 87,647.52	$ 35,423.94	$ 53,830.14
Less:							
Item 1. All Expenditures made during the taxable year in connection with exploration or drilling of wells on properties that produced oil, itemized as follows:							
Labor	69,825.59	102,395.65	36,432.04	12,921.25	19,750.57	15,709.48	26,862.94
Outside Professional Services	30.00	1,265.20	616.10	2,269.00	250.00	799.80	280.00
Fuel, Power, Etc.	1,764.44	3,714.40	1,914.81	490.10	478.43	406.51	2,759.21
Material and Supplies	115.00	200.00	1,242.78	257.13	1,390.45	1,496.23	2,311.38
Tool Rental	62,606.76	95,572.60	33,787.40	26,900.97	20,925.35	18,816.98	30,743.60
Truck and Auto Hire	—.—	91.00	—.—	8.50	638.25	282.25	863.75
Repairs to Equipment used in drilling during the drilling period	51,654.46	79,587.69	34,431.36	10,575.51	8,826.23	8,002.99	8,666.46
Small Tools	2.99	46.26	1.02	—.—	—.—	—.—	—.—
Foamite Materials	1,679.60	101.01•	50.60•	—.—	—.—	—.—	—.—
Drilling Tool Expense Adjustment (Sub rentals received)	17,482.68•	27,383.30•	8,164.68•	12,944.48•	12,661.62•	11,024.02•	17,359.65•
General Development Expense	—.—	—.—	—.—	5,870.96	5,742.6,	4,999.95	7,964.13
Totals	$170,196.16	$255,418.49	$100,190.03	$ 46,348.94	$ 45,340.33	$ 39,490.17	$ 62,892.92
Item 2. Depreciation During the Drilling Period on Equipment used in drilling the Wells referred to in Item No. 1, itemized as follows:							
Derricks—Wood	$ 1,094.63	$ 1,094.63	$ 547.32	$ 1,265.97	$ 1,265.97	$ 632.98	$ 1,265.97
" —Steel	736.52	736.52	368.26	400.18	400.18	200.09	400.18
Casing	11,715.37	11,715.37	5,857.68	5,041.05	5,041.05	2,520.52	5,041.05
Machinery and Tools	1,988.79	1,988.79	994.40	501.76	501.76	250.88	501.76
Drilling Tools	16,563.48	16,563.48	8,281.74	17,320.95	17,320.95	8,660.48	17,320.95
Totals	$ 32,098.79	$ 32,098.79	$ 16,049.40	$ 24,529.91	$ 24,529.91	$ 12,264.95	$ 24,529.91
Item 3. Depreciation of Equipment used for Production of Oil	$ 16,395.33	$ 16,395.33	$ 8,197.66	$ 32,511.50	$ 32,511.50	$ 16,255.75	$ 32,511.48
Item 4. All Expenses Paid by the taxpayer during the taxable year in connection with the production of oil (excluding the depreciation item No. 3)	$ 55,873.03	$ 49,897.50	$ 24,640.18	$106,559.47	$ 7,690.69	$ 32,741.01	$ 24,609.50
Total Deductions (Items 1, 2, 3 and 4)	$274,563.31	$353,810.11	$149,077.27	$209,949.82	$110,072.43	$100,751.88	$144,543.81
Net income from Property as determined by Respondent	$ 96,998.57	$ 53,125.13	$ 73,800.78	$ 16,402.70•	$ 22,424.91•	$ 65,327.94•	$ 90,715.67•
Depletion deduction as determined by respondent in computing the deficiencies	$ 48,499.29	$ 26,562.56	$ 36,900.39	$ —.—	$ —.—	$ —.—	$ —.—

(•) Indicate red figures.

[Title of Court and Cause—Docket Nos. 67179 and 73955.]

SUPPLEMENTAL STIPULATION OF AGREED FACTS.

In its income tax returns for the respective years in controversy, the petitioner claimed Items 1, 2, 3 and 4 as deductions from gross income in computing taxable net income, and the said items were allowed as deductions by the respondent in the determination of the taxable net income for the respective years in controversy.

During each of the years 1925, 1926 and 1927, petitioner made expenditures of the same character as those itemized in Schedule "A" under Item 1. In its tax returns for said years, petitioner deducted said expenditures in determining taxable net income; and the respondent, in his examinations of said returns, allowed said expenditures as deductions in determining taxable net income.

JOSEPH D. BRADY,
Counsel for Petitioner.
(Signed) HERMAN OLIPHANT,
Counsel for Respondent.

[Endorsed]: U. S. B. T. A. Filed at hearing June 24, 1936. [55]

[Title of Court and Cause—Docket Nos. 67179, 73955.]

Promulgated February 10, 1937.

In computing depletion of oil wells under the Revenue Act of 1928, the net income from the property, of which 50 percent is the limit of depletion, may not be reduced by the development expense which the taxpayer deducts in computing taxable net income.

Joseph D. Brady, Esq., for the petitioner.
Hartford Allen, Esq., for the respondent.

OPINION.

Sternhagen: These proceedings were submitted upon stipulations of facts. They present a single question of law in respect of deficiencies for 1929 and 1930, governed by the Revenue Act of 1928. In each the Commissioner, limiting the petitioner's depletion allowance in the case of oil wells to 50 percent of the net income from the property, as required by section 114(b)(3), has treated such net income as reduced by the undisputed development expenses which in the taxable years were taken by the taxpayer as deductions, consistently with an election made in earlier years. The petitioner contends that the net income from the property, 50 percent of which gauges the limitation of the depletion deduction, should be computed without the deduction for such development expenses. The provisions of section 114(b)(3), Revenue Act of 1928, and section 204(c)(2), Revenue Act of 1926, are

identical in language and, as to the 1926 Act, the petitioner's contention was completely sustained in Ambassador Petroleum Co. v. Commissioner, 81 Fed.(2d) 474, reversing 28 B. T. A. 868. If the present proceedings were controlled by the 1926 Act, that decision would be controlling and would, without more, require the reversal of the Commisisoner's present determinations. Mountain Producers Corporation, 34 B. T. A. 409 (on review, C. C. A., 10th Cir.).

But the Commissioner argues that the present cases are distinguishable from Ambassador Petroleum Co. v. Commissioner, supra, because [56] they arise under the 1928 Act and are therefore affected by article 221(i) of Regulations 74, in which the net income from the property, for the purpose of the 50 percent limitation on depletion, is required to be reduced by the amount of development expenses if they have been taken as a deduction in the determination of taxable net income. Thus the Commissioner, by virtue alone of his regulation, seeks an interpretation of the identical terms of the 1928 Act different from the authoritative judicial interpretation of such terms in the 1926 Act. This would give to his regulation a sanction greater than that of the adjudicated meaning of the same term. This is without support. To the contrary, if the meaning of the expression in the 1928 Act were not controlled by the adjudication under the 1926 Act, there would still be support for finding the same meaning in the 1928 Act because of the manifest legislative intention found in the House and Senate reports on the

1928 bill. These, like their predecessors, treat the term "net income from the property" in the depletion section as meaning operating income, a meaning which had been adopted in the administration of the statute. The court held also that reason leads to the same meaning. The Commissioner is without power to change this meaning by a regulation.

The Commissioner says that since the petitioner has elected to deduct its development expenses, the effect of this deduction must be treated as inherent in the election. The election, however, was made long before percentage depletion or its limitation was contemplated. Prior to 1926 the effect of the election was to establish a consistent practice as between deduction and capitalization of development expenses for the purpose of computing taxable net income of the year. This consequence of the election is still effective, but there is no equitable consideration which requires its expansion to reduce the depletion allowance, a consequence unthought of when the election was made.

It results that for years controlled by the Revenue Act of 1928, the taxpayer is entitled to have the 50 percent limitation of its depletion allowance computed upon the net income from the property without reduction by the amounts deducted by it in the taxable years as development expenses or the related depreciation.

Judgment will be entered under Rule 50. [57]

United States Board of Tax Appeals
Washington

Docket No. 67179.

WILSHIRE OIL COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT.

Subsequent to the Board's report, 35 B. T. A. 450, promulgated February 10, 1937, the petitioner, acting under Rule 50, filed a proposed judgment of deficiency of $14,388.92. It appearing that there is no opposition thereto, it is

Ordered, Adjudged and Decided that there is a deficiency of $14,388.92 in income tax for 1929.

Entered Apr. 30, 1937.

[Seal] (Signed) JOHN M. STERNHAGEN,
Member. [58]

United States Board of Tax Appeals
Washington

Docket No. 73955.

WILSHIRE OIL COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JUDGMENT.

Subsequent to the Board's report, 35 B. T. A. 450, promulgated February 10, 1937, the petitioner acting under Rule 50, filed a proposed judgment of deficiency of $31,143.02, and the respondent thereafter filed a computation and a motion for judgment of a deficiency of $35,053.57. Entry of judgment was withheld to give petitioner an opportunity to present reasons against the respondent's proposed judgment. No objection being sbumitted, it is

Ordered, Adjudged and Decided that there is a deficiency of $35,053.57 in income tax for 1930.

Entered Apr. 30, 1937.

[Seal] (Signed) JOHN N. STERNHAGEN,
Member. [59]

[Title of Court and Cause.—Docket Nos. 67179 and 73955.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, James W. Morris, Assistant Attorney General, Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, and Hartford Allen, Special Attorney for the Bureau of Internal Revenue, and respectfully shows:

I.

JURISDICTION.

The petitioner on review (hereinafter referred to as the Commissioner) is the duly appointed, qualified and acting Commissioner of Internal Revnue of the United States, holding his office by virtue of are laws of the United States.

The respondent on review, the Wilshire Oil Company, Inc., (hereinafter referred to as the taxpayer) is a corporation organized under the laws of the State of California, with its principal place of business located at Los Angeles, California. The said Wilshire Oil Company, Inc., filed its income tax returns for the calendar years 1929 and 1930 with the Collector of [60] Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, and within the judicial

circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner filed this petition pursuant to the provisions of Sections 1001, 1002 and 1003 of the Revenue Act of 1926, as amended by Section 603 of the Revenue Act of 1928, as amended by Section 1101 of the Revenue Act of 1932, as amended by Section 519 of the Revenue Act of 1934.

II.

PRIOR PROCEEDINGS.

On June 1, 1932 and August 10, 1933, the Commissioner determined deficiencies in income taxes against the taxpayer for the years 1929 and 1930 amounting to $37,211.88 and $51,144.64, respectively, and sent by registered mail notices of said deficiencies in accordance with the provisions of Section 272 of the Revenue Act of 1928. Thereafter, and on July 28, 1932 and October 6, 1933, the taxpayer filed appeals from the said respective determinations with the United States Board of Tax Appeals, contesting the amount of the deficiencies determined by the Commissioner as aforesaid. The Commissioner filed his answers to the said respective petitions on August 19, 1932 and December 4, 1933, denying the allegations of error contained in said petitions.

Several issues were disposed of by stipulation of the parties and there remained a single issue for presentation to the Board.

The cases were tried before the United States Board of Tax Appeals on June 24, 1936.

On February 10, 1937 the Board promulgated its opinion and on April [61] 30, 1937 entered its decisions, wherein it was ordered and decided that there were deficiencies for the years 1929 and 1930 amounting to $14,388.92 and $35,053.57, respectively.

III.

NATURE OF CONTROVERSY.

The taxpayer is engaged in the business of producing oil and gas from various properties located in California. Under the provisions of Article 243 of Regulations 74, Revenue Act of 1928 (45 Stat. 791, c.852) the taxpayer deducted from the gross income of the respective properties (a) the exploration and drilling expenditures and (b) the depreciation on equipment used in drilling the wells. The items claimed were allowed by the Commissioner as deductions from gross income in computing the taxable net income for each of the years in controversy.

The question involved in the cases, stated generally, is the determination of the amount of depletion allowable as a deduction from gross income for each of the years in controversy, under the provisions of Section 114 (b)(3) of the Revenue Act of 1928 (45 Stat. 791, c.852). The said Section reads as follows:

> "(3) Percentage depletion for oil and gas wells:—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable yead. Such allowance shall not exceed 50 per centum of the net income of the

taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

The specific question involved in the cases is whether in determining the net income from the properties for the purpose of computing the percentage depletion allowance under the limitation provisions of Section 114(b)(3), [62] supra, the taxpayer must consistently deduct from gross income the expenditures and depreciation, items (a) and (b) supra, as required by the provisions of Article 221 (i) of Regulations 74, Revenue Act of 1928 (45 Stat. 791, c.852).

The said Article states that the net income of the taxpayer, as computed without the allowance for depletion, "means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion."

The Commissioner contended that the controverted items must be deducted from gross income so as to arrive at a true net income figure upon which the percentage depletion allowance should be based. The Board, sustaining the contention of the taxpayer, held that the clause contained in Article

221(i) underscored, supra, was invalid and accordingly allowed the taxpayer to compute the percentage depletion allowance on a resultant excessive net income figure.

IV.

ASSIGNMENTS OF ERROR.

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and final decisions rendered and entered by the Board of Tax Appeals manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in the said record, proceeding, opinion and final decisions so rendered and entered by the Board of Tax Appeals: [63]

1. The Board erred in holding and deciding that the provisions of Article 221(i) of Regulations 74, Revenue Act of 1928, were invalid.

2. The Board erred in holding and deciding that the taxpayer could disregard the exploration and drilling expenditures in computing the net income from its respective oil properties for the purpose of determining the percentage depletion deduction.

3. The Board erred in holding and deciding that in computing the net income from the various properties for the purpose of determining the percentage depletion deduction the taxpayer could disregard the depreciation sustained in connection with the drilling equipment used in the development of such properties.

4. The Board erred in holding and deciding that in computing the percentage depletion deduction with respect to the taxpayer's oil and gas properties under Section 114(b)(3) of the Revenue Act of 1928, the taxpayer is entitled to compute the 50 per cent limitation of its depletion allowance on the net income from the properties without reduction for development expenditures and related depreciation, which items were claimed and allowed as deductions from gross income in the computation of the taxable net income for the years in controversy.

5. The Board erred in failing to decide that in computing the percentage depletion allowance under Section 114(b)(3) of the Revenue Act of 1928, the taxpayer is not entitled to compute the 50 per cent limitation of its depletion allowance on the net income of the properties without reduction for development expenditures and the related depreciation, which items were claimed and allowed as deductions from gross income in the computation of the taxable net income for the years in controversy.

[64]

6. The Board erred in that its opinion and decisions are not supported by the evidence and are contrary to law.

7. The Board erred in failing to find all of the material facts.

8. The Board erred in failing to find any facts.

9. The Board erred in finding that there were deficiencies due from the taxpayer in the amounts

of $14,388.92 and $35,053.57 for the years 1929 and 1930, respectively.

10. The Board erred in failing to find that there were deficiencies due from the taxpayer for the years 1929 and 1930 in the amounts of $32,364.67 and $41,168.86, respectively.

Wherefore, the Commissioner petitions that the decisions of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Sgd) JAMES W. MORRIS
Assistant Attorney General
(Sgd) MORRISON SHAFROTH
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
HARTFORD ALLEN,
Special Attorney,
Bureau of Internal Revenue. [65]

United States of America,
District of Columbia—ss.

Hartford Allen, being duly sworn, says that he is a Special Attorney in the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read

said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

(Sgd) HARTFORD ALLEN.

Sworn and subscribed to before me this first day of July, 1937.

(Sgd) GEORGE W. KRIES
Notary Public

My commission expires Nov. 16, 1937.

[Endorsed]: U. S. B. T. A. Filed July 20, 1937.

[66]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Joseph D. Brady, Esq., 458 South Spring Street, Los Angeles, California.

You are hereby notfiied that the Commissioner of Internal Revenue did, on the 20th day of July, 1937, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decisions of the Board heretofore rendered in the above-entitled cases. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 20th day of July, 1937.

(Signed) MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revnue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 24 day of July, 1937.

JOSEPH D. BRADY,
Attorney for Respondent on Review.

[Endorsed]: U. S. B. T. A. Filed July 30, 1937.

[67]

[Title of Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW.

To: Mr. George L. Machris, President, Wilshire Oil Company, Inc., 2455 E. 27th Street, Los Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 20th day of July, 1937, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decisions of the Board heretofore rendered in the above-entitled cases. A copy of the petition for review and the

assignments of error as filed is hereto attached and served upon you.

Dated this 20th day of July, 1937.

(Signed) MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 26 day of July, 1937.

WILSHIRE OIL CO., INC.
By GEORGE L. MACHRIS, Pres.
Respondent on Review.

[Endorsed]: U. S. B. T. A. Filed July 30, 1937.

[68]

[Title of Court and Cause.]

PRAECIPE FOR RECORD.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries (Docket Nos. 67179 and 73955).
2. Pleadings:

(a) Petitions
(b) Answers to Petitions
(c) Amended Answer to Petition (No. 73955)
(d) Amendments to Petitions
(e) Answers to Amendments to Petitions.

3. Opinion promulgated February 10, 1937.
4. Decision (Docket No. 67179) entered April 30, 1937.
5. Decision (Docket No. 73955) entered April 30, 1937.
6. Petition for Review.
7. Notices of Filing Petitions for Review. [69]
8. Stipulation of Agreed Facts.
9. Supplemental Stipulation of Agreed Facts.
10. Praecipe for Record.

(Signed) MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 19th day of August, 1937, and is agreed to (J. D. B.).

(Sgd) JOSEPH D. BRADY,
Attorney for Respondent on Review.

[Endorsed]: U. S. B. T. A. Filed Aug. 24, 1937.

[70]

[Title of Court and Cause.]

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 70, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 30th day of August, 1937.

[Seal] B. D. GAMBLE,
Clerk
United States Board of Tax Appeals.

[Endorsed]: No. 8656. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Wilshire Oil Company, Inc., a corporation, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed September 3, 1937.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

Upon Petition to Review a Decision of the United States Board of Tax Appeals

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8656

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, RESPONDENT

No. 8655

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY, RESPONDENT

No. 8657

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY, RESPONDENT

It is hereby stipulated by and between the parties to the above entitled proceedings, that the same legal questions are involved in each of said cases and that the clerk of said Circuit Court of Appeals may print the record in the case of Commissioner v. Wilshire Oil Company, No. 8656, and may omit the printing of the record in the other two cases.

It is further agreed that the decision of the Circuit Court of Appeals for the Ninth Circuit in the case of Commissioner v. Bandini Petroleum Company, and Commissioner v. Wilshire Annex Oil Company shall abide by its decision in the case of Commissioner v. Wilshire Oil Company.

Dated: September 22, 1937.

JAS. W. MORRIS,
Assistant Attorney General.
JOSEPH D. BRADY,
Counsel for Respondents.

So ordered:

CURTIS D. WILBUR,
Senior U. S. Circuit Judge.

[Endorsed] Filed September 29, 1937. Paul P. O'Brien, Clerk.

79916—38

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Friday, March 18, 1938

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges

No. 8656

Order of submission

Ordered above cause argued by Mr. Ellis N. Slack, Special Assista to the Attorney General, counsel for petitioner, and by Mr. Josep D. Brady, counsel for respondent, and submitted to the Court f consideration and decision.

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Friday, April 1, 1938

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges

No. 8656

Order directing filing of opinion and dissenting opinion, and fili and recording of judgment

By direction of the Court, ordered that the opinion and dissentin opinion this day rendered by this court in above cause be forthwit filed by the Clerk, and that a judgment be filed and recorded in th minutes of this Court in accordance with the majority opinio rendered.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8656. April 1, 1938

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILSHIRE OIL COMPANY, INC., A CORPORATION, RESPONDENT

Upon Petition to Review a Decision of the United States Board o Tax Appeals

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges

DENMAN, Circuit Judge.

This is a petition by the Commissioner of Internal Revenue t review a decision of the Board of Tax Appeals which revised adversely to the Commissioner his determination of income tax deficiencies fo the years 1929 and 1930.

The taxpayer is a California corporation engaged in producing petroleum products from oil and gas leases in Southern California.

Pursuant to Section 23 of the Revenue Act of 1928, the taxpayer in its returns for the years in question deducted from its gross income an allowance for depletion on its oil and gas wells. The Commissioner assessed deficiencies based upon his ruling that that allowance was in excess of that permitted by statute.

The question before the Board and on this appeal concerns solely the interpretation of the phrase "net income" of an oil company under the depletion provision of the Revenue Act of 1928. The provision is (Sec. 114, (b) (3)):

"(3) PERCENTAGE DEPLETION FOR OIL AND GAS WELLS.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the *net income* of the taxpayer (computed without allowance for depletion) *from the property*, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." [Italics supplied.]

The taxpayer, respondent oil company, in its return under the Act of 1928 of income for the years 1929 and 1930, computed the depletion of oil within three properties it owned and upon a leasehold, under a construction of the phrase "50 per centum of the net income of the taxpayer (computed without allowance for depletion from the property," that net income from the property meant net "operating income." It hence did not deduct the capital expenditure in drilling the wells which capital expenditure might yield it income for a score or longer pumping or flowing years. So computed, its 27½ percent of the gross income was less than 50 percent of the net, and hence the entire 27½ percent was allowable as a depletion.

The Commissioner claimed that the phrase, net income from the property, does not mean net "operating income" but means net income after also deducting the capital cost of the creation of the producing plant, i. e., the drilling and installing of pipes and structures necessary for pumping during the life of the well. Since 27½ percent of the gross income of the property exceeded 50 percent of the net income after the deduction of the capital development expense, the Commissioner allowed, as depletion only, this 50 percent of the net. His deficiency assessment increased the total taxable income of the taxpayer by the difference between the depletion as so computed and the computation of the taxpayer.

The phrase "net income from the property" has appeared in the depletion allowance provisions of the income tax act, first, in 1921,[1] and since then in three reenactments—1924,[2] 1926[3] and 1928.

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[1] Sec. 234 (a) (9) "• • • such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made. • • •"

[2] Sec. 204 (c) "• • • but such depletion allowance based on discovery value shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made. • • •"

[3] Sec. 204 (c) (2) "In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. • • •"

Under the 1921 Act, the Commissioner's depletion Regulation limited the deductions in determining the net income of the property to "operating expenses."[4]

When the provision was reenacted in 1924, the phrase "net income from the property" was defined by the report of the Senate Committee as "operating profit." It reads:

"The exception contained in subdivision (c) supersedes the second and third provisos of section 214 (a) (10) and 234 (a) (9) of the existing law. The existing law limits discovery depletion to the operating profit from the property upon which the discovery is made. The bill limits discovery depletion to 50 percent of the operating profit from the property upon which the discovery has been made."

Under the 1924 act the Treasury promulgated the same depletion regulation as for the 1921 act, i. e., confining the deductions to determine income from the property, i. e., "operating expenses."

We thus have the use of the phrase in the 1924 act determined by both the Treasury and the Congress as "operating" profit or income. It is admitted by the Commissioner that, at least until shortly before the 1928 reenactment of the percentage depletion clause, in all cases determining oil depletion by the percentage provisions, the clause was administered under a construction of the phrase "net income from the property" which excluded these capital development expenditures from the deductions determining such net income.

Congress reenacted the phrase in 1926 and the Treasury regulation repeated its limitation of the deductions to "operating expenses."[5]

When the 1928 taxing act here in question was passed, the law thus had been made plain that "net income from the property" means net "operating" income. We are thus required so to interpret the 1928 act under the rule reiterated by the Supreme Court in the recent case of Biddle v. Commissioner, decided January 10, 1938, 82 L. ed. 349, 354:

"Where the law is plain the subsequent reenactment of a statute does not constitute adoption of its administrative construction. Iselin v. U. S., 270 U. S. 245 * * *; Louisville & N. R. Co. v. U. S., 282 U. S. 740 * * *; Helvering v. New York Trust Co., 292 U. S. 455 * * *."

Though the Treasury for years so interpreted the phrase and administered the law, and though the Congress so fixed its meaning, the Commissioner claims that by a regulation under the 1928 act, that act no longer means what it meant when the Congress passed it. Instead of "operating" income, it has been transformed by the subsequent regulation into net income after the deduction of the capital

[4] "(b) Net income is the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less operating expenses, including depreciation on equipment, and taxes, but excluding any allowance for depletion. * * * Operating expenses, depreciation, and taxes on the property upon which the discovery is made, should be applied against the gross income from the same property on the basis of actual expenditures." Revenue Act 1921, Regulations 62, Art. 201 (b).

[5] "Less the deductions in respect to the property upon which the discovery is made including operating expenses, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion." Revenue Act 1926, Regs. 69, Art. 201 (b).

item of expense in drilling and otherwise developing the well before its operation. This regulation claimed to overrule both the law as "plainly" established and the prior regulations is:

"This phrase 'net income of the taxpayer (computed without allowance for depletion)' means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion." Revenue Act 1928, Art. 221 (i), Regulations 74.

The Commissioner urges several arguments in support of this contention. The first is that the parenthetical phrase in the 1924 act and all succeeding acts, i. e.,:

"shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property."

by the exclusion of "depletion" from the allowable deductions, requires the inclusion in deductions of the capital development items. It is a sufficient answer to this argument that the phrase "(computed without allowance for depletion)" was in the act of 1924 when the Senate Committee recommended the legislation as basing the depletion allowance on "operating profit," and when the Treasury, following the Senate interpretation, confined its deductions to "operating expenses." It was in the 1926 reenactment of the depletion clause after both Senate and Treasury interpretation had excluded such capital expenditures from an income computation.

The next argument is that though the tax liability was incurred in the tax years 1929 and 1930, it was not governed by the plainly established meaning of the words "net income from the property" when the legislation was enacted in 1928, but by the contrary regulation, because two years later, in 1932, the Congress reenacted the depletion clause without change. It is a sufficient answer to this contention that when the tax liability was incurred the meaning of "net income from the property" was as plain as Congressional declaration and legislative approval of the Treasury's ruling could make it. Under the rule in Biddle v. Commissioner, supra, taxpayers in making their returns are entitled to rely upon the law as it then is. They are not required to have the prescience to discern a difference in Congressional viewpoint two years in the future. Penn Mutual Life Ins. Co. v. Lederer, 252 U. S. 523, 538. It may be hereafter argued that despite the rule in the Biddle case, and though net income from the property is plainly determined in the 1928 act, and the contrary regulation thereunder is now invalid, the reenactment of the phrase in 1932 should be regarded as an amendment of the 1928 act. However, this is a question we are not called upon to decide in a case involving taxes on income for 1929 and 1930.

Another argument is that, without change in its regulations, the Treasury's practice in 1927 was contrary to the plain and established

meaning of the words in the act of 1926, then controlling, and taxes were assessed for some months before the 1928 act with a capital deduction in depletion determination. The claim is that the Congress is deemed to have known of the practice is violation of its declared interpretation and ratified it in the reenactment of 1928.

We have searched the record in vain for any proof of such a claimed practice. Much less is there anything within or without the record suggesting that Congress knew of such a practice. It certainly is not proved by attempting to have us consider the claimed "General Counsel's Memorandum" 2315, published September 25, 1927, in which that counsel gave his unsolicited opinion, in effect that the Congress and the Treasury were wrong when they interpreted net income as net "operating" profit or income. The Commissioner's brief here lacks the candid admission of his brief in the case of Ambassador Petroleum Co. v. Commissioner, 81 Fed. (2d) 474, where he stated:

"The Commissioner's interpretation was embodied in a General Counsel's Memorandum, which, together with I. T.'s and other informal rulings does not have the force or effect of Treasury Decisions and does not commit the Department to any interpretation of the law. See cautionary notice published in the Internal Revenue Bulletins; also Helvering v. New York Trust Co. 292 U. S. 455."

The New York Trust Company case clearly shows that such a memorandum opinion is evidence neither of a practice following the recommendation or of notice to us or the Congress of such a practice. Nothing is shown here but the ipse dixit of the brief. The taxpayer is as much entitled to proof of the practice as the government is of proof of facts of the claimed deductions.

Another argument is that although it is plainly established that the net income from the oil property of the depletion clause of the act is "operating" income, that plain interpretation by the Congress and the Treasury is wrong because a regulation affecting calculations entirely different from the depletion, gives the anomalous option to the taxpayer to deduct his capital development expenses in computing his entire income from all sources.* Without considering that the exercise of this option ties the taxpayer in all future years to its exclusive use, the argument is made that since the regulation permits the taxpayer to apply inconsistent methods of computation which in a particular tax year may be to his benefit, therefore the Congressional intent, plainly determining the depletion allowance, is wrong.

---

*Treasury Regulations 74, promulgated under the Revenue Act of 1928:

"ART. 243. Charges to capital and to expense in the case of oil and gas wells.

Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, insofar as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. * * *"

It is a sufficient answer to this contention that when the Congress decided, in 1925 and 1926, that the depletion allowance was calculable on an operating profit basis, the anomalous regulation allowing the deduction of capital expenditures from gross general income was in effect. When the "operating" depletion rule received Congressional recognition and approval, the Congress knew the taxpayer had the right to compute his total net income by deducting capital oil development expenditures from his gross income. Nevertheless it based the depletion allowance on net operating income. In this case, the Oil Company, by its election in 1924, had bound itself to deduct its capital development expense in determining its total net taxable income, and omit such capital expenditures from its capital account, for all time in the future under the provision of the regulation that, "An election once made under this option will control the taxpayer's returns for all subsequent years."

A further answer is that, while by the regulation we have the inconsistency of deducting capital expenditures from general gross income, and not deducting them in net income from a particular oil property, which may be advantageous to the taxpayer in a particular tax year, the Government may gain greatly in the future by the requirement that the taxpayer must always thereafter omit his capital development expenditures from his capital account. The fact that the regulation compelled such future accounting, implies that the Treasury contemplated such a beneficial result to its revenues.

The regulation requiring the capital development expenditures to be deducted from current income instead of being capitalized, is not tied to any method of depletion or depreciation. Hence it may well be that over a period of years the loss of tax by a total deduction in the year of expenditure will be more than compensated by the facts (a) that gross income from oil production will increase with the increased price due to inevitable depletion of the world's supply, and hence the income come within the higher percent brackets; (b) the tax brackets of future legislation will be much higher and (c) depreciation and (d) depletion deductions much less, without the capital development expenditures in the amount on which these future items are calculated.

That the tax rates will increase and deductions will become more scant is not a mere fanciful conjecture. The Supreme Court has given warning of this in its recent case of Helvering v. Mountain Producers Corporation, decided March 7, 1938, where it was pressed to reconsider (and overrule) prior decisions because of the "expanding need [for revenue] of State and Nation." In successive years the rate of taxation on corporate income has increased, and pending bills show the corporate burden certain of continuing future increase.

That the world supply of petroleum is limited and that rising prices for oil and gas will inevitably ensue is recognized both by the Government and the industry.

That the Congressional allowances for depletion are shrinking is shown by the 1924 act reducing the 100 percent of the net of the 1921 act to the 50 percent of the net as the maximum, and 2 years later by the 1926 act allowing the 27½ percent of the gross receipts, only if it did not exceed 50 percent of the net.

It is therefore apparent that the regulation creating the anomaly of allowing in a particular first year the capital development deductions from general gross income, tied to a compulsion to follow this method in future years, affords no argument that the Congress was wrong when it plainly made the depletion deduction computable on net "operating" income and hence did not require a "net" after deduction of capital development expenditures.

The fact that the 1926 and 1928 act may be construed as also permitting a computation of full actual depletion,[7] as an alternative to the percentage method, adds nothing to the Commissioner's argument. The added alternative may be revoked at any time. It does not affect the bargain with the taxpayer on an entirely different matter, i. e., the perpetual future deduction of capital development expenditures from gross income.

The double deduction argument has weight only when excluding these necessary future effects of the regulation on which it is based. The Commissioner's brief, failing to mention the above matters fully considered in our opinion in Ambassador Petroleum Co. v. Commissioner, supra, much less to attempt to distinguish or overcome them, is not persuasive to a court in which the Commissioner seeks an overruling of that case.

Affirmed.

WILBUR, Circuit Judge, dissenting:

I dissent. I adhere to the view expressed by me in the dissenting opinion in Ambassador Petroleum Co. v. Commissioner of Internal Revenue, 81 F. (2d) 474, 483. Notwithstanding that, in view of the majority decision in that case, I would concur in the result in the case at bar on the theory that the language of § 114 (b) (3) of the Revenue Act of 1928 is not sufficiently clear to justify a reconsideration of the decision in Ambassador Petroleum Co. v. Comm'r., supra, and that, therefore, the parties should be left to their remedy in the Supreme Court. If I agreed with my brethren that the meaning of the statute involved was entirely clear, I would also agree with their conclusion that the new rule of the Commissioner under the Revenue Act of 1928 could not change the plain language of the statute. However, the statute expressly requires the Commissioner to adopt rules for the determination of the depletion allowance. He has done so. Under those rules so adopted the additional tax determined by the Commissioner accrued. To uphold the tax under the new rule is not inconsistent with the decision of the court in Ambassador Petroleum Co. v. Comm'r., supra. Because of the changed situation

[7] "In no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." Act 1928, Sec. 114 (b) (3).

it is not necessary to overrule that decision in order to reverse the decision of the Board of Tax Appeals herein.

[Endorsed:] Opinion and Dissenting Opinion. Filed Apr. 1, 1938. As amended by order of April 8, 1938. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8656

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

WILSHIRE OIL COMPANY, INC., RESPONDENT

Upon Petition to Review a Decision of the United States Board of Tax Appeals

This cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Board of Tax Appeals in this Cause be, and hereby is affirmed.

[Endorsed:] Filed and entered April 1, 1938. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Friday, April 8, 1938

Before WILBUR, GARRECHT, and DENMAN, Circuit Judges

No. 8656

Order directing amendment of opinion

By direction of Garrecht and Denman, Circuit Judges, ordered that their majority opinion heretofore rendered by this court in above cause be forthwith amended pursuant to memorandum filed.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8656

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC., A CORPORATION, RESPONDENT

Ordered that the opinion be amended as follows:

At page 7 of the printed copy, line 18, substitute 1925 for 1924.

On page 8 of the printed copy, strike out the last paragraph complete on that page and substitute for it the following:

That the Congressional allowances for depletion are shrinking is shown by the 1924 act reducing the 100 percent of the net of the 1921 act to the 50 percent of the net as the maximum, and two years later by the 1926 act allowing the 27½ percent of the gross receipts, only if it did not exceed 50 percent of the net.

FRANCIS A. GARRECHT,
United States Circuit Judge.
WILLIAM DENMAN,
United States Circuit Judge.

[Endorsed:] Order re amendment of opinion. Filed April 18, 1938. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

Certificate of Clerk, U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under rule 38 of the Revised Rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing eighty-seven (87) pages, numbered from and including 1 to and including 87, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of Hon. Robert H. Jackson, Solicitor General of the United States, counsel for the petitioner, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 23rd day of June A. D. 1938.

[SEAL] PAUL P. O'BRIEN, *Clerk.*

Supreme Court of the United States

October Term, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY

Stipulation

It is hereby stipulated and agreed by and between the parties to the above-entitled proceedings that the same legal questions are involved in each of said cases and arise upon facts which are identical in all material respects.

Therefore, it is stipulated and agreed, subject to the approval of this Court, that only the record in Helvering v. Wilshire Oil Co. need be printed, that the records need not be printed in the other two cases; and that if the petitions for writs of certiorari be granted in the three above-entitled cases that records need not be printed nor briefs filed in Helvering v. Bandini Petroleum Co. and Helvering v. Wilshire Annex Oil Co.; that briefs be filed and oral argument presented only in Helvering v. Wilshire Oil Co., and that the decisions in Helvering v. Bandini Petroleum Co. and Helvering v. Wilshire Annex Oil Co. shall abide the decision of this Court in Helvering v. Wilshire Oil Co.

ROBERT H. JACKSON,
Solicitor General.
JOSEPH D. BRADY,
Counsel for Respondents.

JUNE 1938.

U. S. GOVERNMENT PRINTING OFFICE 1938

Supreme Court of the United States

No. 1, October Term, 1939

Order allowing certiorari

Filed April 3, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Reed took no part in the consideration and decision of this application.

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY

Office - Supreme Court, U. S.
FILED
JUN 30 1938
CHARLES ELMORE CROPLEY
CLERK

No. 163

In the Supreme Court of the United States

OCTOBER TERM, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on April 1, 1938, affirming a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 54–56) is reported in 35 B. T. A. 450. The opinion of the Circuit Court of Appeals is reported in 95 F. (2d) 971.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 1, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining the amount of depletion allowable under Section 114 (b) (3) of the Revenue Act of 1928, development expenditures and the related depreciation which the taxpayer elected to deduct currently should be deducted from "the gross income from the property" in arriving at "the net income of the taxpayer" from the property for the purpose of applying the 50 per cent limitation provided therein.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (1) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be

prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—

* * *

* * * * *

(i) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the

depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * *

* * * * *

ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciа-

tion as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. * * *

STATEMENT

The facts may be summarized as follows (R. 48–53):

The respondent is a California corporation engaged in the business of producing oil and gas from various properties located in Southern California (R. 48). In filing its income tax returns for the years 1929 and 1930, the respondent, pursuant to the regulations, claimed and was allowed as deductions from gross income so-called development expenditures in the respective amounts of $606,051.66 and $279,927.04 (R. 52–53). The respondent claimed, however, that in determining its "net income * * * from the property" for the same years, for the purpose of computing the allowable depletion under Section 114 (b) (3) of the Revenue Act of 1928, the development expenditures were not to be deducted. The Board of Tax Appeals upheld this contention of the taxpayer (R. 54–58), and the decision of the Board was affirmed by the Circuit Court of Appeals, Judge Wilbur dissenting (R. 75–84).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the depletion allowance under Section 114 (b) (3) of the Revenue Act of 1928

should be computed without taking into consideration development expenditures and the related depreciation, which items were claimed by the respondent and allowed as deductions in computing the taxable net income for the years in controversy.

2. In holding that development expenditures and the related depreciation, which items the respondent elected to deduct currently, should not be deducted in computing "the net income * * * from the property" under Section 114 (b) (3) of the Revenue Act of 1928.

3. In failing to reverse the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals, in holding that the allowable depletion under Section 114 (b) (3) of the Revenue Act of 1928 should be computed without deducting so-called development expense and the related depreciation, which the respondent elected to deduct currently, has decided an important question of Federal tax law which has not been but should be settled by this Court.

Section 114 (b) (3) of the Revenue Act of 1928 provides that the allowance for depletion shall be 27½ per cent of the gross income from the property but such allowance shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property. Article

243 of Regulations 74,[1] *supra*, permits taxpayers to choose whether to capitalize development expenses or to deduct them from income currently. Pursuant thereto the respondent charged to expense and deducted in its income tax returns for the years 1929 and 1930 development expenses in the respective amounts of $606,051.66 and $279,927.04 and such amounts were allowed as deductions in computing the net income upon which the tax was levied. However, under the decision of the court below, such expenditures need not be deducted in computing the net income from the property for the purpose of determining the allowable depletion.

The court below fell into error in assuming that the expenses in question were capital expenditures. It lost sight of the fact that if a taxpayer elects to deduct such expenses currently, they are then no different than any other expense items connected with the property. The effect of the decision is to permit taxpayers to call the same expenditures capital expenses for one purpose and ordinary and necessary expenses for another purpose. We sub-

[1] All the regulations of the Commissioner, beginning with those issued under the Revenue Act of 1918, have permitted an election with respect to the treatment of development expenses. However, the election, once made, was binding upon all subsequent years' returns. In view of the new basis for depletion provided in the Revenue Act of 1926, a new election, binding upon all subsequent years, was permitted. See T. D. 4025, VI-1 Cumulative Bulletin 75.

mit that, having made an election, a taxpayer should be held to that election for all purposes.

Our contention that development expense should be included in the computation in arriving at the net income from the property where taxpayers have elected to deduct such expenses currently is borne out by the very language of Section 114 (b) (3). It provides that the allowance for depletion "shall not exceed 50 per centum of the net income of the taxpayer (*computed without allowance for depletion*) from the property." [Italics supplied.] Since depletion is an allowable deduction, the specific direction that it shall be excluded from the computation in determining the net income from the property precludes the exclusion of any other deductible item. *Wood* v. *United States*, 16 Pet. 342, 363.

2. The decision of the court below unwarrantably invalidates a Treasury Regulation. Article 221 (i) of Regulations 74 reads in part as follows:

> The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, *development expenses (if the taxpayer has elected to deduct development expenses)*, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. [Italics supplied.]

This regulation is not, as the court below erroneously assumed, a mere administrative interpretation promulgated by the Commissioner under his general power to issue rules and regulations. The regulation was issued by the Commissioner under the specific authority of Section 23 (1) of the Revenue Act of 1928, *supra*, p. 2, which provides for the deduction of—

> a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; *such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner*, with the approval of the Secretary. [Italics supplied.]

The Commissioner having determined, with the approval of the Secretary, that a reasonable allowance for depletion does not include, in effect, a double deduction—or partially double deduction—on account of development expenditures, the Board and the court below were without power to set the determination aside merely on the ground that in their view of the law apart from the regulation the taxpayer's contention was correct.[2] Moreover,

[2] Article 221 (i) of Regulations 74 is the first regulation specifically dealing with the treatment of development expenditures, which the taxpayer has elected to deduct currently, in the computation of the depletion allowance. The court below relied (R. 77) on expressions in earlier regulations (e. g., Revenue Act 1921, Regulations 62, Art. 201 (h)) limiting the deductions in determining "net income from the property" to "operating expenses." It seems apparent that

even if the regulation had originally no greater force than an administrative interpretation, it should have been followed in view of the later legislative history. The regulation has been carried forward and incorporated in all the regulations issued under the subsequent Revenue Acts.[3] Likewise, the provision limiting depletion to "50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property" has been reenacted without change in the Revenue Acts of 1932, 1934, 1936, and 1938. The argument is compelling that the subsequent reenactment of the same provision in the later Revenue Acts constituted legislative approval of the Commissioner's regulations. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459; *Brewster* v. *Gage*, 280 U. S. 327.

3. The decision of the court below is in conflict with the principles enunciated by this Court in *United States* v. *Dakota-Montana Oil Co., supra,* where it was held that development expenses which the taxpayer had elected to capitalize should be recovered through allowances for depletion. It would seem to follow that, if such expenses, when

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development expenditures and the related depreciation are "operating expenses" within the meaning of these regulations when the taxpayer has elected to deduct them currently in computing net taxable income.

[3] See Article 221 (h) of Regulations 77; Article 23 (m)–1 (h) of Regulations 86; and Article 23 (m)–1 (h) of Regulations 94.

capitalized, are recoverable through deductions for depletion, they should not be used when expensed currently to increase the depletion allowance.

4. The Bureau of Internal Revenue advises that the issue here raised is presented in 107 cases, involving approximately $9,000,000 in taxes, now pending before the Board of Tax Appeals and the Income Tax Unit.. It further advises that the question is present in numerous other cases, but because of the manner in which the returns are prepared, the amount involved cannot readily be determined. The question arises in every case where percentage depletion is claimed and is of sufficient importance, we believe, to warrant clarification by this Court.

CONCLUSION

Wherefore it is respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

JUNE 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

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FILED
JUN 30 1938
CHARLES ELMORE CROPLEY
CLERK

No. 164

In the Supreme Court of the United States

OCTOBER TERM, 1938.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on April 1, 1938, affirming a decision of the Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 21–22)[1] is unreported. It was stipu-

[1] By stipulation between the parties, the record in this case is not being printed. Record references are to the unprinted record, a certified copy of which has been filed with the Clerk of this Court.

lated before the Circuit Court of Appeals that the decision in the present case should abide the decision of the Court in *Commissioner* v. *Wilshire Oil Company, Inc.*, in which case a petition for certiorari is being filed simultaneously herewith.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 1, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining the amount of depletion allowable under Section 114 (b) (3) of the Revenue Act of 1928, development expenditures and the related depreciation which the taxpayer elected to deduct currently should be deducted from "the gross income from the property" in arriving at "the net income of the taxpayer" from the property for the purpose of applying the 50 per cent limitation provided therein.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
> In computing net income there shall be allowed as deductions:
>
> * * * * * *
>
> (1) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion

and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—

* * *

* * * * *

(i) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed

without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * *

* * * * * *

ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*— Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion

> and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. * * *

STATEMENT

The facts may be summarized as follows (R. 17–20):

The respondent is a California corporation engaged in the business of producing oil and gas from properties located in Southern California (R. 17). In filing its income tax return for the year 1929 the respondent, pursuant to the regulations, claimed and was allowed as deductions from gross income so-called development expenditures in the amount of $643,284.79 (R. 18). The respondent claimed, however, that in determining its "net income * * * from the property" for the same year for the purpose of computing the allowable depletion under Section 114 (b) (3) of the Revenue Act of 1928 the development expenditures were not to be deducted. The Board of Tax Appeals upheld this contention of the taxpayer (R. 21–22), and the decision of the Board was affirmed by the Circuit Court of Appeals, Judge Wilbur dissenting (R. 38–39).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the depletion allowance under Section 114 (b) (3) of the Revenue Act of 1928 should be computed without taking into consider-

ation development expenditures and the related depreciation, which items were claimed by the respondent and allowed as deductions in computing the taxable net income for the years in controversy.

2. In holding that development expenditures and the related depreciation, which items the respondent elected to deduct currently, should not be deducted in computing the "net income * * * from the property" under Section 114 (b) (3) of the Revenue Act of 1928.

3. In failing to reverse the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The question presented is identical with that presented in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Wilshire Oil Company, Inc.*, No. —, October Term, 1938, petition for a writ of certiorari in which case is being filed simultaneously herewith. For the reasons set forth in the Government's petition in that case, it is respectfully submitted that the petition here should be granted.

ROBERT H. JACKSON,
Solicitor General.

JUNE 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

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No. 165 3

In the Supreme Court of the United States

OCTOBER TERM, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on April 1, 1938, affirming a decision of the Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 34–35)[1] is unreported. It was stipulated before the Circuit Court of Appeals that the

[1] By stipulation between the parties, the record in this case is not being printed. Record references are to the unprinted record, a certified copy of which has been filed with the Clerk of this Court.

decision in the present case should abide the decision of the Court in *Commissioner* v. *Wilshire Oil Company, Inc.*, in which case a petition for certiorari is being filed simultaneously herewith.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 1, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining the amount of depletion allowable under Section 114 (b) (3) of the Revenue Act of 1928, development expenditures and the related depreciation which the taxpayer elected to deduct currently should be deducted from "the gross income from the property" in arriving at "the net income of the taxpayer" from the property for the purpose of applying the 50 per cent limitation provided therein.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (1) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each

case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—

* * *

* * * * *

(i) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed without allowance for depletion, from the

property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * *

* * * * * *

ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*— Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and

depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. * * *

STATEMENT

The facts may be summarized as follows (R. 30–33):

The respondent is a California corporation engaged in the business of producing oil and gas from various properties located in Southern California. In filing its income tax returns for the years 1929 and 1930, the respondent, pursuant to the regulations, claimed and was allowed as deductions from gross income so-called development expenditures in the respective amounts of $185,055.23 and $232,339.62 (R. 32). The respondent claimed, however, that in determining its "net income * * * from the property" for the same years, for the purpose of computing the allowable depletion under Section 114 (b) (3) of the Revenue Act of 1928, the development expenditures were not to be deducted. The Board of Tax Appeals upheld this contention of the taxpayer (R. 34–35), and the decision of the Board was affirmed by the Circuit Court of Appeals, Judge Wilbur dissenting (R. 52–53).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the depletion allowance under Section 114 (b) (3) of the Revenue Act of 1928

should be computed without taking into consideration development expenditures and the related depreciation, which items were claimed by the respondent and allowed as deductions in computing the taxable net income for the years in controversy.

2. In holding the development expenditures and the related depreciation, which items the respondent elected to deduct currently, should not be deducted in computing the "net income * * * from the property" under Section 114 (b) (3) of the Revenue Act of 1928.

3. In failing to reverse the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The question presented is identical with that presented in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Wilshire Oil Company, Inc.*, No. ———, October Term, 1938, petition for a writ of certiorari in which case is being filed simultaneously herewith. For the reasons set forth in the Government's petition in that case, it is respectfully submitted that the petition here should be granted.

ROBERT H. JACKSON,
Solicitor General.

JUNE 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

Nos. ~~163, 164, and 165~~ 1, 2 & 3

In the Supreme Court of the United States

OCTOBER TERM, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 163

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

No. 164

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BANDINI PETROLEUM COMPANY

No. 165

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE ANNEX OIL COMPANY

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

137889—39

SUPPLEMENTAL MEMORANDUM FOR THE PETITIONER

These cases are now pending in this Court on petitions for writs of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit. The petitions set forth as reasons for granting the writs the importance of the question and the fact that the decisions unwarrantably invalidated a Treasury Regulation. At that time the decisions were not in conflict with that of any other Circuit. However, on March 21, 1939, the Circuit Court of Appeals for the Fifth Circuit in *Commissioner v. F. H. E. Oil Co.* handed down an opinion, set out in full as an appendix to this memorandum, holding that the so-called percentage depletion allowance in the case of oil and gas wells should be determined by deducting from the gross income of the taxpayer development expenses which it had elected to deduct currently.

The Circuit Court of Appeals for the Ninth Circuit held that such expenses need not be deducted. The Circuit Court of Appeals for the Fifth Circuit expressly refused to follow the decisions in the Ninth Circuit. There is now, therefore, a direct conflict in the Circuit Courts of Appeals.

CONCLUSION

Wherefore, it is respectfully submitted that the petitions for writs of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

MARCH 1939.

APPENDIX

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Nos. 8800 and 8801

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

F. H. E. OIL COMPANY, RESPONDENT

Petitions for Review of Decision of the United States Board of Tax Appeals (District of Texas)

(March 21, 1939)

Before FOSTER, HUTCHESON, and MCCORD, Circuit Judges.

FOSTER, *Circuit Judge:* These two cases present petitions by the Commissioner of Internal Revenue to reverse decisions by the Board of Tax Appeals. They involve identical questions of fact and law and may be conveniently disposed of by one opinion. The Commissioner disallowed certain deductions by the taxpayer, F. H. E. Oil Company, in making its returns for 1932 and 1933 and determined deficien-

cies respectively of $8,419.04 and $10,841.76. The Board reversed the Commissioner and redetermined deficiencies as $76.97 and $1,721.46 for the respective years. The redetermination by the Board involved a number of separate items. Only those dealing with allowances for depletion are before us for consideration.

The Revenue Act of 1932, which governs, provides as follows:

> SEC. 23 (1) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary.
>
> SEC. B (3) PERCENTAGE DEPLETION FOR OIL AND GAS WELLS.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 77, promulgated under the 1932 Act, so far as necessary to quote, are as follows:

> ART. 221. (h) "Net income of the taxpayer (computed without allowance for depletion)

from the property," as used in section 114 (b) (2), (3), and (4) and articles 221 to 248, inclusive, means the "gross income from the property" as defined in paragraph (g) less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (g) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion.

ART. 236. (4) Option with respect to intangible drilling and development costs in general: All expenditures for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the taxpayer, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs.

The material facts are not in dispute. The taxpayer, F. H. E. Oil Co. is a Texas corporation, organized in 1925. It has an economic interest in a number of oil wells in the West Texas Oil Field entitling it to take deductions for depletion. Since beginning business respondent has consistently capitalized certain items of intangible drilling and development costs, such as physical property having salvage value, together with the cost of installing it, but has deducted other items so classified as expense, in determining its net income returnable for taxation.

The Commissioner allowed as depletion 27½% of the gross income from each oil well or 50% of the net income, whichever was lower. In determining the amount of net income he included in the items to be deducted from gross income the amount of intangible drilling and development costs deducted on its returns by the taxpayer as expense. The Board overruled the Commissioner, on the authority of the following decisions. *Ambassador Petroleum Co.* vs. *Commissioner*, 81 F. (2d) 474; *Mountain Producers Corp.*, 34 B. T. A. 409; and *Wilshire Oil Co., Inc.*, 35 B. T. A. 450, subsequently affirmed in *Commissioner* vs. *Wilshire Oil Co., Inc.*, 95 F. (2d) 971.

The decision in *Ambassador Petroleum Co.* vs. *Commissioner, supra*, deals with the 1926 Act. It reversed the Board and has been consistently followed by the Board ever since. The Court considered the rule of legislative approval urged by the Commissioner and turned it against him. Based upon the history of the law and Treasury rulings, the Court concluded, for the purpose of computing depletion, net income and operating profit are synonymous and held that development costs deducted as expense should be excluded in computing net income. The case of *Commissioner* vs. *Wilshire Oil Co., Inc., supra*, dealing with the Revenue Act of 1928, follows the same line of reasoning. We do not find these decisions persuasive.

The revenue acts of 1918 to 1921, inclusive, contained provisions allowing deduction of a reasonable allowance for depletion of oil and gas wells, based on cost, including cost of development, not otherwise deducted. The Revenue Act of 1924 con-

tinued this allowance for depletion on the cost basis, with the limitation that the deduction should not exceed 50% of the net income from the property, computed without allowance for depletion. The Revenue Act of 1926 made a radical change as to the basis for computing an allowance for depletion. The act provided for a deduction for depletion, based on cost, in computing the gain or loss resulting from a sale or other disposition of the property, and also for an annual deduction for depletion, measured by 27½% of gross income, but not exceeding 50% of the net income, computed without allowance for depletion. These provisions have been continued in all subsequent revenue acts, practically the same as in the 1932 Act, as above quoted.

Treasury Regulations promulgated under the 1926 Act were silent as to the method of computing depletion by the percentage method. Under the 1924 Act the Commissioner had ruled that net income meant net operating revenue and excluded development costs in computing it. For awhile this practice was continued under the 1926 Act, but was changed on September 26, 1927, and the present practice was adopted. See G. C. M. 2315, VI–2 Cumulative Bulletin 21. Thereafter, beginning with Treasury Regulations 74, under the 1928 Act, regulations were adopted substantially the same as those adopted under the 1932 Act, above quoted.

The Commissioner contends that the rule of legislative approval is in his favor, relying upon *U. S. vs. Dakota-Montana Oil Co.*, 288 U. S. 459, and other decisions. We agree with that contention. His decisions under the previous acts were certainly not approved by the enactment of the 1926 statute.

Nor do we think the short time he applied the old rule under the 1926 Act estopped him from changing it, if convinced he was wrong. After the Commissioner had changed his ruling, the pertinent provisions of the 1926 Act were reenacted in the 1928 and subsequent revenue acts without substantial change. However, the decision of the question presented does not depend upon the application of the rule.

The revenue laws adopted before the 1926 Act show conclusively that if costs of development were deducted as expense they could not thereafter be added to increase the basis for depletion. We find nothing in the subsequent statutes tending to show Congress intended to adopt a different principle when depletion is deducted annually and determined by the percentage method.

The deduction of intangible costs of drilling and development from gross income reduces the net income upon which taxes are assessed. If there was no allowance for depletion the tax would be paid on that basis. The statute is plain and unambiguous. Necessarily, if development costs are excluded in computing net income, in those instances where 27½% of the gross income exceeds 50% of the net income, they enter into and add to the basis for depletion. The only reasonable construction of the statute is that net income, computed without allowance for depletion, means what is left after every allowable item, except depletion, is deducted from gross income.

The regulations are reasonable, fair to the taxpayer and conform to the intention of Congress. We consider that when a taxpayer elects to de-

duct intangible costs of drilling and development as expense that item must be treated the same as all other deductible items in computing net income. The Commissioner was right in including such deductions in determining net income for the purpose of applying the 50% limitation.

The petition is allowed, the judgment of the Board is reversed, and the cause is remanded for further proceedings not inconsistent with this opinion.

A true copy:
Teste:

Clerk of the United States Circuit Court of Appeals for the Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1939

No. 1

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 1

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 54–56) is reported in 35 B. T. A. 450. The opinion and dissenting opinion in the Circuit Court of Appeals (R. 72–80) are reported in 95 F. (2d) 971.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 1, 1938 (R. 79). The petition for a writ of certiorari was filed June 30, 1938, and was granted April 3, 1939 (R. 82). The jurisdic-

tion of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Section 114 (b) (3) of the Revenue Act of 1928 allows an arbitrary deduction for depletion of oil and gas property in the amount of 27½% of the gross income from the property during the year, but provides that the "allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property".

In computing its taxable net income, the taxpayer deducted development expenditures. May it refuse to take these same deductions in computing net income for the purpose of applying the 50 per-cent limitation on the depletion allowance?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in Appendix A, *infra*, pp. 30–31.

STATEMENT

The facts were stipulated and may be summarized as follows (R. 48–53):

The respondent is a California corporation engaged in the business of producing oil and gas from various properties located in Southern California (R. 48). In filing its income tax returns for the years 1929 and 1930, the respondent, pursuant to

the regulations, claimed and was allowed as deductions from gross income so-called development expenditures in the respective amounts of $606,051.66 and $279,927.04 (R. 52–53).[1] The respondent claimed that in determining its "net income * * * from the property" for the same years, for the purpose of computing the allowable depletion under Section 114 (b) (3) of the Revenue Act of 1928, the development expenditures were not to be deducted. The Commissioner, on the other hand, ruled that since the development expenses were deducted by respondent in determining its taxable net income they should likewise be deducted in computing its "net income" for the purpose of applying the 50 percent limitation on depletion under Section 114 (b) (3). Thus, for the year 1929, the Commissioner's computations with respect to the properties[2] involved are as follows (R. 52):

---

[1] These figures include, in addition to actual development expenses, depreciation on equipment used for development purposes. No distinction is drawn between these two items by either party in this litigation, and as used hereinafter the term "development expenses" will be understood to embrace such depreciation as well.

[2] The present suit involves three properties for the year 1929, namely, the so-called Peterson, Baker, and Crawford leases. The same properties and, in addition, the so-called Buckbee lease are involved for the year 1930. For convenience, the computations shown above represent a consolidation of the computations with respect to the separate properties appearing on the schedule at R. 52.

Gross income from the properties		$1,001,375.17
Deductions:		
Production expense (Items 3 and 4)	$171,399.03	
Development expense (Items 1 and 2)	606,051.66	
Total expense		777,450.69
Net income from property (computed without allowance for depletion)		223,924.48
50 percent of that net income		111,962.24

Accordingly, since 50 percent of the net income from the properties as thus computed was less than 27½ percent of the gross income, the Commissioner limited the depletion allowance to $111,962.24. The taxpayer claimed that the $606,051.66 development expense deducted from gross income in computing its taxable net income should not be deducted to determine the net income from the properties in applying the 50 percent limitation. Thus, under the taxpayer's computation, the net income for depletion purposes would be $829,976.14 (i. e., $1,001,375.17 gross income minus $171,399.03 production expense), and 50 percent thereof would not be less than 27½ percent of the gross income which it claimed in full as its depletion allowance.

Similarly, for the year 1930, the gross income from the properties was $370,448.72; the production expense, $285,390.90; and the development expense, $279,927.04. The total expenses were thus $565,317.94, which completely wiped out any taxable net income from the properties. The Commissioner, therefore, ruled that no depletion could be

allowed under the 27½ percent provision.[3] The taxpayer, however, contended that the development expense should not have been deducted for the purpose of Section 114 (b) (3), and that under its computation the net income would be $85,057.82 (i. e., $370,448.72 gross income minus $285,390.90 production expenses). Accordingly it claimed the arbitrary depletion allowance to the extent of one-half of the net income as computed by it, or $42,528.91.

The so-called development expense which the taxpayer deducted in computing its taxable net income but not in computing its net income for the purposes of Section 114 (b) (3) related to the exploration and drilling of wells on the properties. They consisted of such items as labor, supplies, tool rental, repairs to drilling equipment, as well as depreciation upon drilling equipment, such as derricks, casings, machinery, and tools (R. 52, items 1 and 2).

The Board of Tax Appeals held that the development expense need not be deducted in computing the 50-percent limitation, and the Circuit Court of Appeals, one judge dissenting, affirmed.

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[3] This ruling did not mean that the taxpayer was denied any allowance for depletion. On the contrary, it was entitled to all the depletion actually sustained during the year, for Section 114 (b) (3) specifically provides that the depletion allowance shall in no case be less than it would be if computed without reference to the arbitrary provisions there set forth.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the depletion allowance under Section 114 (b) (3) of the Revenue Act of 1928 should be computed without taking into consideration development expenditures and the related depreciation, which items were claimed by the respondent and allowed as deductions in computing the taxable net income for the years in controversy.

2. In holding that development expenditures and the related depreciation, which items the respondent elected to deduct currently, should not be deducted in computing "the net income * * * from the property" under Section 114 (b) (3) of the Revenue Act of 1928.

3. In failing to reverse the judgment of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

Section 114 (b) (3) of the 1928 Act provides that the allowance for depletion "shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property." In determining its taxable net income, respondent deducted development expenses from gross income, in accordance with permission granted to it by the Treasury Regulations. Nevertheless, it claims that it need not deduct those expenses for the purpose of computing the depletion allowance.

The parenthetical clause in Section 114 (b) (3) excludes only the depletion allowance itself in the determination of net income thereunder. The specific direction that depletion is to be excluded from the computation precludes the exclusion of any other deductible items, such as development expenses.

The regulations promulgated under the Revenue Act of 1928 provide that development expenses (if a taxpayer has elected to deduct them in computing taxable net income) shall be included in the computation of the net income from the property, for the purpose of the 50 percent limitation. And the provision thus limiting the depletion deduction to 50 percent of the net income from the property has been reenacted without change in the Revenue Acts of 1932, 1934, 1936, and 1938. These reenactments constitute legislative approval of the regulations.

The practical effect of the decision of the court below is to permit a double deduction for the same expense. There is nothing in the statute to indidate that Congress intended to allow a double deduction, and such a construction should, if possible, be avoided.

The theory of depletion is that it represents capital extracted from the property. Therefore, if the taxpayer elects to deduct development expenses from current income, it should not be permitted to recover again the same expenditures through the

form of depletion allowances, since it has already had its capital restored. That Congress intended that development expense should be deducted from the gross income in arriving at the net income from the property is shown by the legislative history of the provisions in question.

ARGUMENT

THE DEDUCTIONS TAKEN IN COMPUTING TAXABLE NET INCOME SHOULD LIKEWISE BE TAKEN INTO ACCOUNT IN COMPUTING ALLOWABLE DEPLETION UNDER SECTION 114 (b) (3)

1. Since a mine or oil well represents a wasting asset it is apparent that the receipts therefrom do not constitute true profit to the owner, unless there be charged against those receipts a proportionate part of his capital investment which is being depleted. "The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production." *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366; *United States* v. *Ludey*, 274 U. S. 295, 302.

The basic statutory provisions which thus permit the deductions from gross income on account of depletion of mines, oil and gas wells, and other natural deposits are contained in Section 23 (l) of the Revenue Act of 1928. But, in addition, Congress has singled out oil and gas wells for favored treatment by allowing an alternative arbitrary depletion deduction equal to 27½ percent of the gross

income from the property during the taxable year. Section 114 (b) (3) of the Revenue Act of 1928.[4] However, that artificial allowance is limited not to exceed 50 percent of "the net income of the taxpayer (computed without allowance for depletion) from the property * * *." Section 114 (b) (3).[5]

The present case deals with that 50 percent limitation, and arises in the following manner:

In the drilling of oil wells, as distinguished from actual production of oil after the wells have been drilled, numerous incidental expenses are generally incurred for wages, fuel, repairs, hauling, etc., which are generically described as development expenses, or intangible drilling or development expenses. The question had arisen years ago as to whether such expenditures were deductible from gross income as business expenses or whether they were in the nature of capital outlays. Admittedly, they were on the borderline between deductible business expenses and nondeductible capital outlays. Therefore, in recognition of the doubtful character of such expenditures, the Treasury

[4] These provisions first appeared in the law as Section 204 (c) (2) of the Revenue Act of 1926 (c. 27, 44 Stat. 9), and were thereafter reenacted without substantial change as Section 114 (b) (3) of the Revenue Acts of 1928, *infra*, 1932 (c. 209, 47 Stat. 169), 1934 (c. 277, 48 Stat. 680), 1936 (c. 829, 49 Stat. 1014), and 1938 (c. 289, 52 Stat. 447).

[5] In every instance, however, the taxpayer is guaranteed a deduction for at least the actual depletion sustained, for Section 114 (b) (3) provides that "in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

Regulations gave each taxpayer an option either to deduct such expenditures as business expenses or to capitalize them.[6] These regulations have been held to be valid. *Ramsey* v. *Commissioner*, 66 F. (2d) 316 (C. C. A. 10th), certiorari denied, 290 U. S. 673; *Grison Oil Corp.* v. *Commissioner*, 96 F. (2d) 125 (C. C. A. 10th), certiorari denied, 305 U. S. 613. Cf. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459.

In the instant case, the taxpayer had elected to treat such expenditures as business expenses and during the years 1929 and 1930 it claimed and was allowed deductions in the respective amounts of $606,051.66 and $279,927.04 on account of such expenditures (R. 52–53). But, after having thus taken advantage of those deductions in the computation of its taxable net income, it then claimed, in

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[6] All the regulations, beginning with those issued under the Revenue Act of 1918, have offered that election, but have provided that once made it would be binding for subsequent years. Regulations 45, Article 223; Regulations 62, Article 223; Regulations 65, Article 225; Regulations 69, Article 223; promulgated, respectively, under the Revenue Acts of 1918, 1921, 1924, and 1926.

In view of the new basis for depletion provided in the Revenue Act of 1926 (i. e., the 27½ percent deduction), a new election binding upon all subsequent years was permitted. T. D. 4025, VI–1 Cum. Bull. 75 (1927). Thereafter, the regulations in somewhat greater detail continued the option as before. Regulations 74, Article 243; Regulations 77, Article 236; Regulations 86, Article 23 (m)–16; Regulations 94, Article 23 (m)–16; and Regulations 101, Article 23 (m)–16; promulgated, respectively, under the Revenue Acts of 1928, 1932, 1934, 1936, and 1938.

the same tax return, that the deductions were in the nature of capital outlays to be charged to capital account rather than to be deducted from gross income for the purpose of computing net income from the property in applying the 50 percent limitation on the depletion allowance. It is our position that these expenses must be treated consistently; that if the taxpayer enjoys the privilege of deducting them from gross income for the purpose of reducing its taxable net income it should likewise be compelled to treat them as deductions in applying the 50 percent limitation in Section 114 (b) (3). To hold otherwise, as was done by the court below, would result in part at least in according the taxpayer a double deduction with respect to the same expenditures.

2. Once these expenses have been deducted in computing taxable net income, they do not differ from any other kind of business expenses or current deductions in connection with the property, and therefore may not be ignored in determining the net income upon which the depletion deduction is based. It is hardly likely that Congress meant "net income" to be one thing for the purpose of imposing the basic tax and another thing for the purpose of computing the depletion allowance. Had it intended so contradictory a result, it would undoubtedly have taken pains to make that purpose clear.

This conclusion is fortified by the language and structure of Section 114 (b) (3). It provides that

the depletion allowance "shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property." Net income consists of gross income less the allowable deductions, and, since depletion is an allowable deduction, Congress specifically excluded it by the parenthetical clause. Had it desired to exclude any other allowable deductions from the computation, it would have similarly specifically mentioned them. The case calls for the application of the familiar rule of statutory construction embodied in the maxim *expressio unius est exclusio alterius.* The specific direction that depletion is to be excluded from the computation in determining the net income precludes the exclusion of any other deductible item. Cf. *Helvering* v. *Stockholms &c. Bank,* 293 U. S. 84, 90; *Arthur* v. *Cumming,* 91 U. S. 362, 363–364.

In *Helvering* v. *Mountain Producers Corporation,* 303 U. S. 376, 382, this Court held that the term "gross income from the property" means the gross income from oil and gas and that the term should be taken in its natural sense. We believe that the term "net income * * * from the property" likewise should be taken in its natural sense and that it means the actual net income from the property, not some theoretical figure which is arrived at by excluding a portion of the actual deductible expenses.

3. The Government's position is supported by administrative practice of some twelve years'

standing, and follows precisely Treasury Regulations that have been promulgated under five successive revenue Acts. The applicable Regulations have the sanction not merely of the general provisions of the revenue Act authorizing the issuance of "all needful rules and regulations" (Section 62 of the Revenue Act of 1928), but are more specifically founded upon Section 23 (l) of the 1928 Act, which, after granting a reasonable allowance for depletion, provides that such allowance is "in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary." Pursuant to that authority, Article 221 (i) of Regulations 74 lays down the following rule:

> The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, *development expenses (if the taxpayer has elected to deduct development expenses)*, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * * [Italics supplied.]

Like provisions appear in Article 221 (h) of Regulations 77, promulgated under the Revenue Act of 1932; Article 23 (m)–1 (h) of Regulations 86, promulgated under the Revenue Act of 1934; Article 23 (m)–1 (h) of Regulations 94, promulgated un-

der the Revenue Act of 1936; and Article 23 (m)-1 (h) of Regulations 101, promulgated under the Revenue Act of 1938.

These regulations unambiguously cover the present case. They declare that in determining net income for the purpose of the depletion limitation, development expenses must be subtracted if the taxpayer has elected to deduct them as expenses. Only by holding these regulations invalid can the result below be sustained. But we respectfully submit that these regulations are reasonable, and that the Commissioner of Internal Revenue has not exceeded his power in issuing them. Not only are they entitled to enjoy the presumption of correctness which usually attaches to an administrative construction, but they are more, in addition, considerably more than an administrative interpretation of the statute. They have behind them the provisions of Section 23 (l) spelling out with particularity the fact that the "reasonable allowance" for depletion in all cases must be under rules and regulations to be prescribed by the Commissioner. These regulations are therefore legislative in character rather than purely interpretative. The Commissioner was acting well within the scope of his discretion when he ruled that a reasonable allowance for depletion does not include, in effect, a double deduction—or partially double deduction—on account of development expenditures. Neither the Board of Tax Appeals nor the court below had authority to declare these regulations invalid

merely because they differed with the Commissioner as to his exercise of discretion in prescribing the terms and conditions upon which the depletion allowance would be permitted.

Moreover, even if the latitude open to the Commissioner were merely that ordinarily permissible in the case of purely interpretative rulings, these regulations would nevertheless be controlling. In substance, the same provisions appeared again in regulations issued under the Revenue Acts of 1932, 1934, 1936, and 1938, which reenacted the pertinent statutory provisions without change. Under the familiar rule such repeated reenactment carries with it legislative approval of the regulations. *Helvering* v. *Winmill*, 305 U. S. 79, 83; *Hassett* v. *Welch*, 303 U. S. 303, 312; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466; *Brewster* v. *Gage*, 280 U. S. 327, 337.

This rule applies with equal force where the taxable year precedes the reenactments and is governed by the original statute rather than where it is governed by one of the reenacting statutes. *Brewster* v. *Gage, supra*; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 307–308; *Reinecke* v. *Smith*, 289 U. S. 172, 175. The court below therefore plainly erred when it held (R. 75) that the reenactments beginning in 1932 could have no bearing upon the construction of the identical provisions in the Revenue Act of 1928 as set forth in the regulations promulgated thereunder and as applied to the years 1929 and 1930.

4. The practical effect of the decision below is to permit a double deduction for the same expense, since the taxpayer immediately secures a deduction of 100 per cent of the development expense when the amount is deducted in computing taxable net income, plus a further deduction when the sum is excluded from depletion computation.[7] Yet this Court has repeatedly declared that taxing statutes should be construed, if possible, to avoid such an anomalous result. In *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, the Court, in speaking of a claim for a deduction, which, if permitted, would have been the equivalent of a double deduction for the same item, said (p. 68):

> If allowed, this would be the practical equivalent of double deduction. In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent and equality of treatment of taxpayers will not be attributed to lawmakers.

See also *McLaughlin* v. *Pacific Lumber Co.*, 293 U. S. 351, 355; *Burnet* v. *Aluminum Goods Co.*, 287 U. S. 544, 550; *United States* v. *Ludey*, 274 U. S. 295, 301.

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[7] Whenever the 50 percent limitation comes into play, the depletion deduction is a factor of the deductions from gross income. Under those circumstances, the development expenses will reduce taxable income whether charged as a current expense in computing the basic net income or charged to capital with a resulting increase in the net income which limits the depletion deduction. To use it in both ways is to have one expense serve double duty in producing deductions from taxable income.

There is nothing in Section 114 (b) (3) to indicate that Congress intended to allow a double deduction and such a construction should be avoided, since deductions are allowable only when plainly authorized. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 689–690; *Ilfeld Co.* v. *Hernandez, supra*, at 66.

Furthermore, depletion is but a return of capital, since it represents capital extracted from the property. And the fact that the deduction is based upon an arbitrary percentage of the gross or net income from the property in no way changes the fundamental theory of the allowance. *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 367; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 467. Therefore, if a taxpayer deducts development expenses from current income, he should not be permitted to recover again the same expenditures through the form of depletion allowances. In deducting such expenses from current income, he has had his capital restored to him, and any further allowance would be in addition to the "reasonable allowance" contemplated by the statute.

5. Although the statute here involved is the Revenue Act of 1928, the opinion of the court below seems to be predicated largely upon earlier statutes (beginning with the Revenue Act of 1921) and regulations which are quite different. The statutory provisions here involved, granting the arbitrary 27½ per cent depletion allowance in the case of oil and gas wells are contained in Section 114

(b) (3) of the 1928 Act, and appeared in the law for the first time as Section 204 (c) (2) of the Revenue Act of 1926.

The provisions relied upon by the court below, on the other hand, first appeared as Sections 214 (a) (10) and 234 (a) (9) of the Revenue Act of 1921. Those sections deal with depletion generally (not limited to oil and gas wells), and provide for an allowance based upon "discovery value," and not upon any percentage of gross receipts. The deduction was limited not to "exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made * * *." Sections 214 (a) (10) and 234 (a) (9) of the Revenue Act of 1921. And the Treasury Regulations issued thereunder (Regulations 62, Article 201 (h)) spoke of net income as meaning gross income from the property less "operating expenses." Similar statutory provisions appeared in the Revenue Act of 1924, except that the limitation was reduced to fifty percent (Section 204 (c)), and Regulations 65, Article 201 (h), issued thereunder continued the provisions of the predecessor regulations.*

* The court below seems to assume that the same provisions were also present in the regulations issued under the 1926 Act. (R. 74, footnote 5.) But those provisions merely dealt with discovery depletion which was continued in the 1926 Act only in the case of mines, etc., but not in the case of oil and gas wells. As to the latter, the statute for the first time provided for percentage depletion, and the regulations issued under the 1926 Act dealing with percentage depletion contain no such provisions.

The court below seized upon the phrase "operating expenses" as it appeared in those early regulations; concluded that they did not embrace development expenses; and therefore held that the term "net income" thereupon became so irrevocably fixed in the law that new regulations taking a contrary position must of necessity be fatally defective, although issued under different provisions of a later statute (Revenue Act of 1928) and operating prospectively only. We respectfully submit that the court erred.

(a) Even if the earlier regulations had been issued under identical statutory provisions, and even though they had unambiguously covered the present situation, then nevertheless the Commissioner would have been empowered to issue different regulations under the later statute which would operate with prospective effect only.

The statute itself recognizes the power to issue new regulations which change the rule of liability. Section 605 of the Revenue Act of 1928, amending Section 1108 (a) of the Revenue Act of 1926, plainly states:

> In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

Moreover, this Court has in at least two cases given effect to amended regulations, notwithstanding the reenactment of the statutory provisions while the former regulations were in force. *Morrissey v. Commissioner*, 296 U. S. 344; *Murphy Oil Co. v. Burnet*, 287 U. S. 299.

In the *Morrissey* case, regulations defining the term "association" were promulgated under the Revenue Acts of 1918 and 1921. Thereafter, under a subsequent statute, new regulations were issued which radically modified the earlier definition. The Court held the later regulations were to be applied despite legislative reenactment during the continuance of the earlier regulations, and stressed the necessary and appropriate range of administrative power to reexamine and reformulate its rules (pp. 354–355):

> As the statute merely provided that the term "corporation" should include "associations," without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as to meet administrative exigencies or conform to judicial decision. * * * We find no ground for the contention that by the enactment of the Revenue Act of 1924 the Department was limited

to its previous regulations as to associations. * * *

In the *Murphy Oil Co.* case, the Treasury Department in 1926 changed its regulations which had been in force for over six years with respect to the application of the depletion allowance to bonuses received by a lessor of oil properties (pp. 303–304). This Court approved the amended regulations, noting that they "must be taken to have received the approval of Congress," since the applicable statutory provisions had been thereafter reenacted in 1928 and 1932 (p. 307). Similarly here, the provisions of the 1928 Act relied upon by the Government were reenacted in 1932, 1934, 1936, and 1938.

The court below committed serious error by refusing to give effect to the 1932 reenactment (R. 75). Regulations had been promulgated early in 1929 under the Revenue Act of 1928 which specifically covered the present case and governed the years 1929 and 1930, here involved. The holding of the court below leads to the extraordinary conclusion that where the Commissioner finds it desirable under a newly enacted statute to promulgate regulations different from those issued under preexisting law, and actually does promulgate different provisions, those new provisions can never be given any legal effect under that statute although they are limited to prospective operation only. In short, the Commissioner is compelled by the new Revenue Act to issue new regulations but is without any

power to apply them. One supposes they might serve the purpose of notice that similar new regulations would be issued, and would then be applied, under the next revenue act, when and if enacted. It is impossible that Congress could have intended to require regulations which served only as dress rehearsal, or to strait-jacket the administrative process by imposing a waiting period of an indefinite number of years.

The instant case is sharply to be distinguished from *Helvering* v. *Reynolds Co.*, 306 U. S. 110, where the Court refused to permit an amended regulation to apply with *retroactive* effect. There the new ruling appeared for the first time in 1934 and the question was whether it could be applied to transactions fully consummated during the year 1929, thereby affecting the tax liability for that year. Here, on the other hand, the regulations apply prospectively only. They were issued under the Revenue Act of 1928 early in 1929, and the tax years involved are 1929 and 1930. Moreover, these regulations were foreshadowed by G. C. M. 2315, VI-2 Cumulative Bulletin 21, issued in September, 1927, in which it was stated that thereafter[*] (p. 22):

> if a taxpayer elects to treat development expenditures as ordinary and necessary business expenses * * * in computing tax-

[*] While it is true that that ruling was issued merely as an opinion of the General Counsel of the Treasury rather than as an official Treasury Decision and therefore is not entitled

able net income, such expenditures must be deducted in determining the net income from the property, which amount is used as a limitation in the computation of the depletion allowance based on income.

(b) In the foregoing discussion we have endeavored to show that even if the statutory provisions relating to percentage depletion here involved were present in the Revenue Acts of 1921 and 1924, then nevertheless the Commissioner would have been entitled to change his construction of those provisions in the 1928 Act. But our case is stronger. The provisions for percentage depletion did not appear until the Revenue Act of 1926. Under that statute, the Commissioner made no ruling as to the meaning of the term "net income" as applied to percentage depletion of oil and gas properties.[10] His first official ruling in regard to the computation of net income under the arbitrary oil-depletion provision was made under the succeeding statute

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to the same weight as a Treasury Decision, nevertheless it was published and circulated as widely as a Treasury Decision, and in fact accurately described both the past and future practice of the Treasury.

[10] However, after the issuance of G. C. M. 2315, *supra*, in September 1927, the Treasury in fact did undertake under the 1926 Act, to follow the practice later set forth in the regulations here involved. In *Ambassador Petroleum Co.* v. *Commissioner*, 81 F. (2d) 474 (C. C. A. 9th), the same court below ruled against the Government in a case arising under the 1926 Act. The Government did not ask for further review in that case, but rather waited for the instant case where the question of the validity of the new regulations could squarely be presented to this Court.

and is the very one under attack in the instant case.

(c) True, there were somewhat comparable provisions relating to discovery depletion in the 1921 and 1924 Acts, as well as in the 1926 Act, to the extent that natural resources other than oil and gas properties were involved. And the regulations issued under those provisions could be regarded as construing "net income" in accord with the position maintained by the taxpayer herein.[11] But if the legislative history of these provisions is examined, it will be found that even they were not correctly interpreted in the early regulations relied upon by the taxpayer and the court below.

Those provisions imposed a limitation upon the amount of depletion allowable based upon discovery value. Section 214 (a) (10) of the 1921 Act provided that the allowance "shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery

[11] Those regulations were not unambiguous. The critical words upon which the taxpayer and the court below relied are "operating profit" and "operating expense." From these words, it is necessary to go one step further and say that they excluded consideration of development expenses. Similar phrases appeared, as the taxpayer will no doubt point out, in the legislative history of some of the early statutes. But it is equally arguable that such phraseology was no more than a convenient locution to describe net income from or expenses chargeable to the operation of certain properties, without any attempt at segregation of the varying types of deductible expenses.

is made * * *."[12] The reason for this limitation was explained by the Senate Committee on Finance. The committee stated (S. Rept. No. 275, 67th Cong., 1st Sess., p. 15) that the limitation was imposed—

> in order to make it certain that the depletion deduction when based upon discovery value shall not be permitted to offset or cancel profits derived by the taxpayer from a separate and distinct line of business. * * *

In other words, although Congress was willing to let the taxpayer employ the depletion deduction to absorb any taxable gain from the property involved, it was not willing to permit the use of that deduction to offset profits realized by the taxpayer from other sources.

But the construction which the taxpayer seeks to perpetuate accomplishes the very thing that Congress attempted to guard against. For example, consider the figures in this very case with respect to the year 1930. By deducting development expenses in the computation of its taxable net income, the taxpayer not only eliminated all taxable

[12] Beginning with the Revenue Act of 1924 the deduction was further restricted so as not to exceed 50 percent of the net income from the property.

The court below seemed to find this reduction, when considered with a conjectured increase in oil prices and in tax rates, a sufficient reason to disregard the anomalous consequence of double deductions (R. 77–78).

income from the four properties involved, but also obtained the benefit of a $194,869.22 loss:

Gross income from the properties		$370,448.72
Deductions:		
Production Expense	$285,390.90	
Development Expense	279,927.04	
Total Expense		565,317.94
Loss		194,869.22

The Commissioner therefore ruled that since the percentage depletion allowance was limited to 50 percent of the net income from the properties and since the taxpayer had no net income from the properties, no deduction on account of percentage depletion could be allowed. The taxpayer, on the other hand, by failing to deduct the development expenses in the application of the 50 percent limitation, arrived at the following result:

Gross income from the properties	$370,448.72
Deduction: Production Expense	285,390.90
Net income	85,057.82
Depletion deduction (50 percent of the net income)	42,528.91

Thus, if this result is permitted to stand, the taxpayer not only has no taxable income from these properties, and not only has a loss of $194,869.22 arising out of them which it can employ against income from other sources but it will also have an artificial depletion allowance of $42,528.91 which it can likewise use to reduce taxable income realized from other activities. This is the very result which Congress sought to prevent.

Moreover the history of the Revenue Act of 1926 shows that when that legislation was under consideration by Congress it was the general understanding that development expenses constituted a part of the operating expense of the property. This is shown by the statement of L. C. Manson, Esq., a depletion expert and counsel for the Senate Select Committee Investigating the Bureau of Internal Revenue, made at the hearings before the Committee on Finance on H. R. 1, 69th Cong., 1st Sess., which eventually became the Revenue Act of 1926. Senator Jones, of New Mexico, inquired whether the old, established companies charged the development expense to the cost of operation or whether they capitalized it. Mr. Manson replied that most of them charge it to the cost of operation, and that such expense is deducted from their tax as an operating expense. See full text of colloquy in Appendix B, *infra*, pp. 32–34.

6. The respondent's position is also contrary in principle to the sound result reached in *Ramsey* v. *Commissioner*, 66 F. (2d) 316 (C. C. A. 10th), where a taxpayer had similarly deducted development expenses currently in accordance with the option given him by the regulations. In a later year he sold the properties, and in returning the profit on sale added to cost the development expenditures which he had theretofore deducted as expenses. The Commissioner denied this double deduction, holding that since the taxpayer had exercised his

option to deduct the items as business expenses, he could not later treat them as additions to capital. The Circuit Court of Appeals stated (p. 318) that the question presented was "whether the regulation may permit the irrecoverable costs of drilling oil wells to be classed as an expense of *operation* rather than as a 'permanent improvement or betterment'" [italics supplied], and thereupon upheld the Commissioner. This Court denied certiorari, 290 U. S. 673. See also *Grison Oil Corp.* v. *Commissioner*, 96 F. (2d) 125 (C. C. A. 10th), certiorari denied, 305 U. S. 613.

The same principle applies here. Just as the taxpayer in the *Ramsey* case, having elected to deduct development expenses from current income, could not thereupon classify them as capital outlays for the purpose of recovering a greater amount of capital upon sale, so here the taxpayer should not be permitted in the same tax return to change its position by charging these expenditures to capital for the sole purpose of increasing the depletion allowance.

CONCLUSION

Under the last clause in Section 114 (b) (3) the taxpayer is entitled to the full amount of depletion actually sustained by it. The only question here is the extent to which it is entitled to claim the arbitrary percentage allowance over and above the actual depletion. The statute limits that arbitrary allowance to 50 percent of the net income

from the property computed without allowance for depletion. Here the taxpayer has enjoyed the advantage of deducting development expenditures from taxable gross income. Both the statute and regulations require consistent treatment of those expenditures in applying the 50 percent limitation. The judgment below should be reversed.

Respectfully submitted.

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SEPTEMBER 1939.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—* * *

* * * * *

(i) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 percent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * *

* * * * *

ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*— Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. * * *

APPENDIX B

Hearings of the Senate Committee on Finance on H. R. 1, 69th Cong., 1st Sess., pp. 163, 200:

Senator JONES of New Mexico. Before you leave that oil business, I want to clear up a point in my own mind. You take the old established oil companies that are also engaged in developing new properties, in prospecting. Do they charge the expenses of that prospecting to the *cost of operation?*

Mr. MANSON. Yes.

Senator JONES of New Mexico. Or capitalize it?

Mr. MANSON. No; most of them charge it to *cost of operation.*

Senator JONES of New Mexico. What is the effect of that?

Mr. MANSON. *The money they spend in prospecting is deducted from their tax as an operating expense,* and, in addition to that, they get discovery value on the property. [Italics supplied.]

* * * * *

Senator JONES of New Mexico. Now, we have this situation with respect to the oil industry. We have the large companies which try to keep up their replacement through charges to expense of operation, and deduct that from their net income. That is being done now, as I understand it, in a large percentage of the cases. But there is a large number of other concerns starting into the business which have no net income from any source from which they can deduct the expense of exploration.

Now it seems to me that there should be a uniform provision put in there so that those concerns shall be put upon the same basis, and the company which charges exploration to expense takes no hazard to that expense in carrying on its operation, and is not entitled to the same discovery value, we will call it, or depletion value on account of discovery that the other concern is.

The CHAIRMAN. Well, Senator Jones, that happens today. You or I go out onto the range now and wildcat and we spend our money; no one gets any credit for that, and why should they? That is an investment that the man makes. That is what you or I do; we are going to bet that we are going to get some oil here. But if we do find it then it is exactly the same as the metal mine, and we have got to keep up that exploration, or else we would not have any profit.

Senator JONES of New Mexico. I understand that, Senator. I am not warring against that thought at all, but if a large percentage of the concerns use capital in the development process then it seems to me that all concerns ought to charge these development operations to capital account and not reduce their net income from other sources by reason of that.

Senator REED of Pennsylvania. In other words, they ought to be compelled to form their accounts on the same basis.

Senator JONES of New Mexico. That is the idea.

Senator REED of Pennsylvania. One man should not put his drilling expense into capital account and the other charge it off to expense for the purpose of taxation.

Senator JONES of New Mexico. Yes.

Senator REED of Pennsylvania. Whatever he may do on his books.

Senator JONES of New Mexico. Yes, whatever he may do on his books for the company's statements, and so on, that is one thing, but I think for taxation purposes they ought to all be put on the same basis.

U. S. GOVERNMENT PRINTING OFFICE, 1939

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CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT

OF THE

UNITED STATES.

Nos. 163, 164 and 165.

No. 163.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
vs.
WILSHIRE OIL COMPANY, INC.

No. 164.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
vs.
RANDINI PETROLEUM COMPANY.

No. 165.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,
vs.
WILSHIRE ANNEX OIL COMPANY.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR RESPONDENTS IN OPPOSITION.

JOSEPH D. BRADY,
458 South Spring Street, Los Angeles,
Attorney for Respondents.

August 15, 1938.

Parker & Baird Company, Law Printers, Los Angeles.

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*Italics supplied throughout unless otherwise indicated.

Opinions Below.

The opinion of the Board of Tax Appeals [R. 54-56] is reported in 35 B. T. A. 450. The opinion of the Circuit Court of Appeals is reported in 95 Fed. (2d) 971. There are no reported opinions in Nos. 164 and 165 and by stipulation [R. 81] the records therein have not been printed. Accordingly this brief will deal only with No. 163.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 1, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Counter-Statement of Question Presented.

Should the amount of percentage depletion otherwise allowable for the taxable years 1929 and 1930 be reduced pursuant to a Regulation adopted for the *first* time in 1929, where the taxpayer, in accordance with a binding election made in 1925 in reliance upon the uniform administrative construction of identical language of the Revenue Acts of 1921 and 1924, was *required* by the Treasury in the later years to charge off "intangible drilling and development costs" incurred in drilling oil wells.

Throughout almost its entire length, the petition conveys the false impression that respondent, *at the time of filing its returns here involved*, exercised an election to deduct its development expenditures in determining taxable net income instead of capitalizing them. (Petition, pp. 2, 4, 6, 7, 8, 9.) As the record shows, the respondent made its election in this regard in its return for 1925 [R. 53], over

three years before the Commissioner made his "about-face"[1] and *first* promulgated the portion of Article 221 (i) upon which he now relies. This 1925 election bound the respondent "for all subsequent years." Art. 243, Regs. 74; Art. 223, Regs. 69.[2]

Statutes and Regulations Involved.

Revenue Act of 1928, c. 852, 45 Stat. 791:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

* * * * * * * *

"(1) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * * * * *

"SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * * * *

"(b) *Basis for depletion.*—

* * * * * * * *

---

[1]To borrow from Circuit Judge Swan in *Bliss v. Commissioner*, 68 Fed. (2d) 890, 893, affirmed *Helvering v. Bliss*, 293 U. S. 144.

[2]See also Note 1 on page 7 of the petition.

"(3) *Percentage Depletion for Oil and Gas Wells.* —In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

Treasury Regulations 74, promulgated February 15, 1929, under the Revenue Act of 1928:

"ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—Section 23(1) provides that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. See section 114 and articles 241 and 611 with reference to the basis for computing depreciation and depletion.

"The essence of these provisions of the Act is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either the cost of his property, or the value of his property on the basic date plus, in either case, subsequent allowable capital additions (see articles 242 and 243), but not including land values for purposes other than the extraction of minerals. (But see section 114(b)(3) and article 241.)

* * * * * * * *

"When used in these articles (221-257) covering depletion and depreciation—

* * * * * * * *

"(f) 'Operating profit' is the net amount received from the sale of minerals before depletion and depreciation are deducted. It is distinct from net income, as defined in section 21.

* * * * * * * *

"(i) 'Depletion allowance based on the income from oil and gas wells': The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase 'net income of the taxpayer (computed without allowance for depletion)' means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, *development expenses (if the taxpayer has elected to deduct development expenses)*, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, then the gross income shall be assumed to be equivalent to the market or field price of oil and gas before conversion or transportation. Depreciation, taxes, and such expenses as overhead (which can not be directly attributed to any particular property) shall be allocated on the basis of the ratio of the number of units produced from the property on which depletion is claimed to the total number of units produced from the operating division in which the property is located. In cases where the taxpayer, in addition to producing oil and gas, engages in additional activities such as operating refineries and trans-

portation lines, depreciation, taxes, and such expenses as overhead which can not be directly attributed to any specific activity, shall be allocated to the production of oil and gas on the basis of the ratio which the operating expenses and development expenses (if the taxpayer has elected to deduct development expenses) directly attributable to the production of oil and gas bear to the taxpayer's total operating expenses and development expenses."

"ART. 241. *Depletion in the case of oil and gas wells.*—Under section 114(b)(3), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (See article 221(i).) In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, 'the property', as the term is used in section 114(b)(3) and this article, refers to the separate tracts or leases of the taxpayer."

"ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a *development expense* or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reason-

able allowance for depreciation. The cost of drilling non-productive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. *An election once made under this option will control the taxpayer's returns for all subsequent years.* Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return."

Counter-Statement.

The facts may be summarized (as they were by the Commissioner in the Circuit Court of Appeals) as follows [R. 48-53]:

Respondent is a California corporation engaged in the business of producing oil and gas from various properties located in southern California [R. 48].

During the years 1929 and 1930, the respondent operated some eleven or twelve oil and gas properties. However, the controversy here is limited, for the year 1929, to the Peterson, Baker and Crawford leases. For the year 1930 the controversy concerns those three properties and the Buckbee lease [R. 48-50].[3]

---

[3]Actually only *two* properties, the Peterson and Baker leases, are involved in the year 1930—see note 6, *infra*, p. 10.

In determining the deficiency for the year 1929, the *Commissioner allowed* as a deduction for the depletion of the three properties the sum of $111,962.24, which sum he arrived at as follows [R. 52]:

Gross income from the three properties		$1,001,375.17
Deductions:		
Production expense	$171,399.03	
Development expense	606,051.66	
Total expense		777,450.69
Net income of the taxpayer (computed without allowance for depletion) from the property		223,924.48
Percentage depletion limited to 50% of the net income from the property		111,962.24

In determining the deficiency for the year 1930, he found that the taxpayer sustained a loss from the operation of the four properties, and hence *allowed no deduction for depletion*. He computed the net *loss* from the operation of the properties as follows [R. 52]:

Gross income from the properties		$370,448.72
Deductions:		
Production expense	$285,390.90	
Development expense	279,927.04	
Total expense		565,317.94
Loss		$194,869.22

NOTE: To this point the Statement is an exact reproduction of the Statement made by the Commissioner at pages 4-5 of his brief in the Court below. The following additional facts (not mentioned by the Commissioner) are also pertinent and material.

Regulations 69 were promulgated under the Revenue Act of 1926 on August 28, 1926. Under Article 223 thereof, such incidental expenses are as paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of an oil and gas property, drilling of wells, building of pipe lines, and development of such property, may *at the option of the taxpayer* be deducted as a development expenditure (in determining taxable net income) or charged to capital account. The Regulations promulgated under Revenue Acts of 1918, 1921 and 1924 provided for the same option. T.-D. 4025, VI-1 Cumulative Bulletin 75.

But the Regulations also provided that an election *once made* under this option will control the taxpayer's returns *for all subsequent years.* Art. 223, Regs. 69; Art. 243, Regs. 74.

In its tax return for the year 1925, the respondent elected to deduct its development expenditures in determining *taxable* net income [R. 53]. At that time the administrative practice, first adopted shortly after the enactment of the Revenue Act of 1921, which was the first Act employing the phrase, "net income from the property," had consistently been that development expenditures should *not* be treated as a deduction in computing the "net income from the property" *regardless* of whether the taxpayer corporation under Article 223 elected to treat such expenditures as deductions in computing taxable income or to charge them to capital. G. C. M. 2315, VI-2 Cumulative

Bulletin 21. This administrative construction had been called to the attention of Congress and approved by it at the time the 1924 and 1926 Revenue Acts were enacted. See *Ambassador Petroleum Co. v. Commissioner*, 81 Fed. (2d) 474, at pages 476-8; also the quotations from Committee Reports set forth in Appendix, *infra*, pp. 15 and 16.

Not until three years after respondent filed its 1925 return did the Commissioner, in his Regulations 74,[4] *first* attempt to add the *new* condition of Art. 221(i) upon which he relies here.[5]

The legislative history of the Revenue Act of 1928 shows clearly that "net income from the property," as used therein, was not intended to have any different meaning from that assigned to *identical* language in the Acts of 1921, 1924 and 1926. See quotations, Appendix, *infra*, pp. 16 to 18, from Senate Report No. 960 and House Report No. 1882 on the Revenue Bill of 1928.

The Board of Tax Appeals held that the Commissioner could not by regulation change the settled meaning of "net income *from the property*" [R. 54-58], and the decision of the Board was affirmed by the Circuit Court of Appeals [R. 75-84].[6]

---

[4]Promulgated February 15, 1929.

[5]See first sentence of Note 2, page 9 of petition.

[6]Although not a part of the Record on Appeal, the recomputations submitted to the Board under Rule 50, and upon which its judgments were based, show an increase in the depletion allowance of $163,278.01 for 1929 and $50,960.73 for 1930. Even under the Board's decision, the respondent received no percentage depletion allowance whatever in 1930 with respect to its Buckbee and Crawford properties—cf. R. 52, last line.

Reasons Why the Writ Should Be Denied.

1. The opinion below deals with the 1928 Act. It merely followed the prior decision of the same Court in *Ambassador Petroleum Co. v. Commissioner*, 81 Fed. (2d) 477, involving *identical* language of the Act of 1926. The *Ambassador* case was decided February 5, 1936. The then Solicitor General (now Mr. Justice Reed) declined to apply for certiorari. No explanation is offered as to why the question is deemed more important now than it was in February, 1936.

2. There is no conflict between the decision in the case at bar and decisions in other Circuits—indeed, the Ninth Circuit is the only one which has decided the point.

The petition asserts (p. 11) that the issue here raised "is presented in 107 cases, involving approximately $9,000,000.00 in taxes, now pending before the Board of Tax Appeals and the Income Tax Unit." It fails to inform this Court that the same issue is pending in the Fifth and Tenth Circuits.

Counsel for respondent now has before him copies of the *printed* records filed June 8, 1938 in the Fifth Circuit in two cases of *Commissioner of Internal Revenue v. F. H. E. Oil Company*, Nos. 8800-1, wherein the Commissioner's petitions for review of memorandum decisions of the Board were filed February 12, 1938. The sole issue there involved is identical with that presented here, except that those cases involve the Act of 1932.[1]

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[1]Copies of the records in the Fifth Circuit cases above mentioned have been lodged with the Clerk of this Court, so that they may be inspected if desired.

The Clerk of the Board advises that on June 27, 1938, the Commissioner filed petitions for review by the Tenth Circuit of the decision of the Board in the case of *Ralph W. Crews, et al. v. Commissioner*, reported 37 B. T. A. 387 (No. 57), promulgated February 23, 1938. The *Crews* case involves the Act of 1928.

The decisions which will undoubtedly be rendered during the next six months by the Fifth and Tenth Circuits may well agree with that in the case at bar, in which event there would be no need to burden this Court with deciding the meaning of a statutory provision which has appeared in every revenue statute beginning with the Act of 1921. The petition herein is premature.

3. The decision below was correct because (a) the legislative and administrative history of the statute and three prior revenue acts permits no other conclusion; (b) the same considerations which impelled this Court to construe the phrase, "gross income from the property" (upon which the percentage depletion allowance is *primarily* based), to mean gross *operating* income,[8] require that the phrase "net income from the property" be construed to mean net *operating* profit—as it was prior to 1929;[9] (c) it would be grossly inequitable to change the long-existing rule upon which the taxpayer relied in making its election in 1925, especially where the Commissioner is holding the taxpayer to the *burdens* of such election.

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[8]Cf. *Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312; *Helvering v. Mountain Producers Corp.*, ... U. S. .....; *Helvering v. Elbe Oil Land Development Co.*, ... U. S. ....., the last two decided March 7, 1938.

[9]See Appendix, *infra*, pp. 15 to 18, as to the legislative and administrative history.

Every contention now advanced by the Commissioner was rejected by the Treasury in its *original* consideration of the meaning of "net income from the property" in the 1921 Act. The attempted change of administrative practice, as first officially reflected in Regulations 74, was undoubtedly induced by G. C. M. 2315, *supra*, promulgated September 26, 1927, which was expressly based upon the erroneous premise that "net income from the property," as used in the percentage depletion allowance provision, meant the same thing as the statutory "net income" to which the tax rate applied. The reasoning of *Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312, has since demonstrated the fallacy of the premise, but the Commissioner has not corrected the erroneous conclusion which resulted therefrom.

4. Contrary to the assertion made at page 11 of the petition, it is obvious that the question here involved does *not* arise "in every case where percentage depletion is claimed." It can arise *only* where the intangible development expenditures, when added to production expense, exceed 45% of the "gross income from the property." The question does not arise where development expenditures have been capitalized, as in *U. S. v. Dakota-Montana Oil Co.*, 288 U. S. 459. Nor does it arise where the development expenditures are incurred in one taxable year and production of oil is first obtained in the succeeding taxable period; in such a case, which is not uncommon, the taxpayer would be required, by reason of its binding election made in 1925, to charge off the development expenditures

in the year made, with little or no benefit for tax purposes. In the case at bar the taxpayer operated eleven oil properties during the taxable years [R. 49]—yet the question arises as to only three of the properties for 1929 and only two[10] for the year 1930 [R. 50].

Conclusion.

No conflict of decisions in the Courts below has been shown, and the decisions of the Board and the Circuit Court of Appeals herein are correct. The question is involved in appeals now pending in the Fifth and Tenth Circuits, and the determination of the necessity for clarification by this Court may well await the decisions of those Circuits. The petition should be denied.[11]

Respectfully submitted,

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Attorney for Respondent.

458 South Spring Street,
Los Angeles, California.

August 15, 1938.

---

[10]See Note 6, *supra*, p. 10.

[11]The question here presented certainly cannot compare in importance with that involved in *Hamersley v. United States*, certiorari denied, 300 U. S. 659. Yet in that case (No. 564, October Term, 1936) Solicitor General Reed, while expressly conceding that the case presented a question of importance, nevertheless contended—successfully—that the petition should be denied because no conflict of decisions in the courts below had been shown and the decision of the Court of Claims was correct.

APPENDIX.

1924 Act:

Report of Committee on Ways and Means on the Revenue Bill of 1924 (H. Rep. No. 179, 68th Congress, First Session, p. 18):

> "(10) The last part of subdivision (c) supersedes the second and third provisos of section 214 (a)(10) and 234(a)(9) of the existing law. The existing law limits discovery depletion to the *operating profit* from the property upon which the discovery is made. The bill limits discovery depletion to 50 per cent of the *operating profit* upon which the discovery has been made."

Report of the Senate Finance Committee (S. Rep. No. 398, 68th Congress, First Session) contains a similar statement at page 20.

NOTE: "Operating profit," the term used by both Committees, had been defined in Art. 201(f) of Regulations 62, under the 1921 Act, as "the net income from mineral production before depletion and depreciation are deducted. It is distinct from net income." Compare definition of "operating profit" in Art. 221 (f) of Regs. 74, *supra*, p. 5.

1926 Act:

Report of Committee on Ways and Means on Revenue Bill of 1926 (H. Rep. No. 1, 69th Congress, First Session, page 6):

> "The discovery depletion deduction limitation of an amount not in excess of 50 per cent of the net income of the taxpayer from the property upon which the discovery was made, provided in existing law, is retained in this provision."

Report of Senate Finance Committee (S. Rep. No. 52, 69th Congress, First Session) contains a similar statement at page 17.

The Conference Report (H. Rep. No. 356, 69th Congress, First Session) contains a similar statement at page 32.

NOTE: The foregoing reports show: (a) that the 68th Congress knew that "net income from the property," as used in the 1921 Act, had been construed to mean "operating profit" and intended the similar phrase in the 1924 Act to be given the same meaning; (b) that although the 69th Congress originated the percentage depletion allowance in 1926, it nevertheless intended that "net income from the property" should have the same meaning as in the Acts of 1921 and 1924.

1928 Act:

When the 1928 Revenue Act was passed the principal change over the earlier law was a rearrangement of the various sections involved. No change was made with respect to the depletion allowance. A careful study of the Committee Reports on the 1928 Bill fails to reveal any comment on the depletion allowance in so far as the phrase "net income from the property" is concerned. A change was made with respect to the allowance for depletion where property is held by one person for life with remainder to another, and in case of property held in trust, and provisions were inserted in the 1928 Act to cover this situation. See Section 23 (1), Revenue Act of 1928. These

changes originated with the Senate Finance Committee. The Senate Finance Committee Report (S. Rep. No. 960, 70th Congress, First Session, page 20), contains the following:

> "Sec. 23(k) and (l) Depreciation and Depletion—Life Estates and Trusts—The House *bill makes no change in existing law* with respect to these deductions. The Committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship *in these two classes of cases* under the existing law.
>
> "In the case of life tenant and remainderman the bill provides that deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property. * * * In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the will. * * * The bill contains similar provisions as to deductions for depletion."

The Conference report on the 1928 Revenue Bill (H. Rep. No. 1882, 70th Congress, First Session, page 11), recognizes this change as follows:

> "Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction shall be considered as the absolute owner; * * * in the case of prop-

erty held in trust the allowable deduction is to be apportioned between the income beneficiary and the trustee in accordance with the pertinent provisions of the will. * * * The bill contains similar provisions as to deduction for depletion. The Senate amendment provides for an equitable apportionment in the deduction of this case. And the House recedes.

"Amendments Nos. 31 and 32. The purpose and effect of these amendments, which relate to the deduction for depletion in the case of property held by one person and remainder to another person, and in the case of property held in trust, is similar in effect to amendment No. 30. And the House recedes."

Thus, the Committees had the depletion provisions called particularly to their attention when drafting the 1928 bill, and made changes in the provisions relating to depletion in so far as they affected life tenants and trusts, but they failed to make any other change in the section. In fact, the Senate bill states specifically that the House bill makes no change in existing law with respect to depletion deductions. The inference to be drawn is that Congress in adopting the 1928 Act approved the section as it stood under the earlier law and approved the interpretation that had been previously placed thereon, intending that except for the changes made, the provisions relating to depletion should remain unchanged.

No. 1

In the

Supreme Court of the United States

October Term, 1939

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner

v.

Wilshire Oil Company, Inc.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

---

BRIEF FOR RESPONDENT

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No. 1

In the

Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENT*

Opinions Below

The opinion of the Board of Tax Appeals [R. 54-56] is reported in 35 B.T.A. 450. The opinion and dissenting opinion in the Circuit Court of Appeals [R. 72-80] are reported in 95 F. (2d) 971.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered April 1, 1938 [R. 79]. The petition for a writ of certiorari was filed June 30, 1938, and was

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*Italics supplied throughout unless otherwise indicated.

granted April 3, 1939 [R. 82]. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

Section 114 (b) (3) of the Revenue Act of 1928 allows an arbitrary deduction for depletion of oil and gas property in the amount of 27½% of the gross income *from the property* during the taxable year, but provides that the "allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) *from the property*".

In taxpayer's return for the year 1925 it deducted its development expenditures in computing its *taxable* net income [R. 53]. By so doing it became irrevocably bound, under Art. 223 of Regs. 69 and Art. 243 of Regs. 74, to do likewise in its returns "for all subsequent years," including the taxable years 1929 and 1930 here involved. At the time the taxpayer's 1925 return was filed, it had been the consistent administrative practice since the question first arose in 1921 not to require development expenditures to be deducted in determining "net income *from the property*" for the purpose of the *limitation* on the depletion deduction, regardless of whether the taxpayer elected

to capitalize them or to deduct them in computing *taxable* net income. This administrative practice had been approved by Congress in enacting the Revenue Acts of 1924, 1926 and 1928.

The *first* official attempt to change the settled meaning of "net income from the property"—by Art. 221 (i) of Regs. 74—occurred in February, 1929, nine months subsequent to the approval of the statute here involved. This was three years after the binding election made by the taxpayer in its 1925 return, and the Commissioner never has released the taxpayer from its agreement to deduct development expenditures in computing *taxable* net income "for all subsequent years."

Thus the *true question* may be fairly stated as follows:

May the Commissioner, by a regulation promulgated for the first time subsequent to the approval of the applicable Revenue Act of 1928, interpret the term "net income * * * from the property", as used in *that* statute, in a manner diametrically opposed to the consistent construction of *identical* language in the Acts of 1921, 1924 and 1926, specifically approved by Congress, especially when the Commissioner refuses to release the taxpayer from the permanently binding effect of an election made in its return for 1925 on the faith of the established and consistent prior construction?

Statute and Regulations Involved

The statute and regulations involved, as set forth in Appendix A of the Commissioner's brief, are incomplete in important respects, particularly in the *omission* of the following sentence which appears in Art. 243 of Regs. 74:

> "* * * An election once made under this option will control the taxpayer's returns for all subsequent years. * * *"

By reference to page 5 of the Commissioner's petition for certiorari, it will be observed that this vitally important sentence was not omitted there.

Art. 223 of Regs. 69 under the 1926 Act contained language identical with that quoted above.

The statutes and regulations which the taxpayer conceives to be involved are are follows:

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * * * * *
>
> (1) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. * * *
>
> (For percentage depletion in case of oil and gas wells, see section 114 (b) (3).)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * * * *

(b) *Basis for depletion.*—

* * * * * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Treasury Regulations 74, promulgated February 15, 1929 under the Revenue Act of 1928:

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*—

* * * * * * * *

(i) "Depletion" allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 percent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference

to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. * * *

* * * * * * * *

ART. 243. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. * * * *An election once made under this article will control the taxpayer's returns for all subsequent years.*

Treasury Regulations 69, promulgated August 28, 1926, under the Revenue Act of 1926:

ART. 223—Identical with Art. 243, Regs. 74, *supra.*

Statement

Respondent admits, as asserted in petitioner's brief, p. 3, that in its returns for 1929 and 1930, it deducted, in computing *taxable* net income, development expenditures in the respective amounts of $606,051.66 and $279,927.04. But the respondent had no free choice in this respect—it was *required* to deduct these amounts because, by electing, in its 1925 return, to deduct items of the same character, respondent had in effect entered into a contract[1] with the Commissioner that it would continue that practice "for all subsequent years." [R. 53; Art. 223, Regs. 69.]

Respondent admits that the Commissioner ruled that no depletion could be allowed under the 27½ percent provision, but denies the assertion of the first sentence of footnote 3, p. 5; the record shows that the Commissioner allowed no depletion deduction *whatever* in computing the deficiencies for 1930 [R. 52, last line].

The taxpayer is not claiming, in the case of any of its oil properties, a depletion allowance in excess of the statutory 27½% of the gross income therefrom. Its sole claim is that the Commissioner is not justified in *cutting down* the 27½% allowance by taking into account the taxpayer's development expenditures.

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[1]As to element of contract, compare *Ilfeld Co. v. Hernandez*, 292 U. S. 62, 65, where this Court said: "The making of the consolidated return constituted *acceptance* * * * of the regulations that had been prescribed."

Summary of Argument

The meaning of the applicable statute—the Revenue Act of 1928—should be ascertained as of May 29, 1928, the date of its approval. The phrase here involved, "net income from the property," originated in the Revenue Act of 1921 as a *limitation* on discovery depletion. It was then construed by the Treasury, as the Commissioner concedes, in a manner favorable to the taxpayer's contentions here. It was reenacted in the Revenue Act of 1924 after the Treasury's construction, which was a reasonable one, had been brought to the attention of Congress and approved. Although the Revenue Act of 1926 substituted percentage depletion for discovery depletion, the identical *limiting* formula of 50% of the "net income from the property" was "retained," as the Congressional Committee reports show. That the Treasury considered the Act of 1926 required no change in the meaning of "net income from the property" is shown by the fact that it made no change in Regs. 69, promulgated under that statute; and by the further fact that Treasury Decision 4025, issued in June, 1927, made no reference to any projected change. Art. 221 (i) of Regs. 74, here involved, was not published until 1929, nine months after the approval of the Act of 1928. The Commissioner admits that this was the "first official" attempt, approved by the Secretary of the Treasury, diametrically to change, by regulation, the meaning which had been consistently

given to *identical* language in the Acts of 1921, 1924 and 1926. The only judicial construction of "net income from the property," as used in prior Acts, is found in *Ambassador Petroleum Co. v. Commissioner*, 81 F. (2d) 474 (C.C.A.-9th), and is in favor of the taxpayer.

In its tax return for 1925 respondent elected to deduct development costs in determining *taxable* net income. It thereby accepted the condition of Regulations 69 that it must do likewise "for all subsequent years." This election was made long before Regulations 74 were issued and on the faith of the original and consistent Treasury practice that it would not have to deduct such costs in determining "net income from the property." For the Commissioner to attempt to withdraw one of the inducements to the election, while holding taxpayer to the burdens, is highly unreasonable and grossly inequitable. In such circumstances at least, the Treasury has no power to change the plain and settled meaning of statutory language.

Under the reasoning of *Helvering v. Reynolds Tobacco Co.*, 306 U. S. 110, the enactment of the Act of 1932 and subsequent revenue statutes does not amount to sanction of retroactive enforcement of the 1929 regulation, in the teeth of the former regulations which received Congressional approval, by the passage of successive Revenue Acts, including that of 1928.

ARGUMENT.

I. The Administrative and Legislative History of Prior Revenue Acts Clearly Shows the Invalidity of the Change Made by the Commissioner in Regulations 74.

The Revenue Act of 1928, here involved, was approved May 29, 1928. What did Congress, *on that date*, mean by "net income * * * from the property"? The answer must be sought, it is submitted, from a consideration of the meaning assigned by the Treasury Department and by Congress to *identical* language in *prior* revenue acts.

The phrase in question *originated* in Section 234 (a) (9) of the Revenue Act of 1921. It was reenacted *without change* in Section 204 (c) of the 1924 Act, in Section 204 (c) (2) of the 1926 Act, and in Section 114 (b) (3) of the 1928 Act.

Granting *arguendo* that the phrase was ambiguous when *first* used in 1921, and conceding also that Congress, *at that time*, intended that the Commissioner, "in order to effectuate the legislative intent", should exercise "wide discretion in respect of" its interpretation and application (*cf. Burnet v. S. & L. Bldg. Corp.*, 288 U. S. 406), it is conceded by the Commissioner that the Treasury gave the very question here involved thorough consideration "Shortly after the enactment of the Revenue Act of 1921," and reached the decision that "the net income *from the property*" should "be computed *without regard* to development expenditures * * * regardless" of the manner of exercise by a taxpayer of the option granted under Article 223 of Regs. 62. G.C.M. 2315, VI-2 Cumulative Bulletin 21,

reproduced in full in the Appendix, *infra,* p. 59. This decision was "*uniformly* followed in closing a great number of cases," not only under the 1921 Act but under the 1924 Act as well. G.C.M. 2315, *supra.* It was also reflected in Art. 201 (h) of Regs. 62, promulgated February 15, 1922. That Article defined "net income from the property" as—

> "the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less *operating* expenses, including depreciation on equipment, and taxes, but excluding any allowance for depletion * * *."

The studied and deliberate distinction drawn by the Treasury itself in Regs. 62 between the "*operating* expenses" which are to be deducted in determining "net income from the property" and the treatment of *development* costs, is shown by comparing Art. 201 (h), quoted *supra,* with Art. 223 of the same regulations, which provided that such latter costs may at the option of the taxpayer be deducted (in determining *taxable* net income)—

> "as a *development* expense."[2]

Now let us examine the legislative history. Under the 1921 Act, Section 234 (a) (9), the depletion allowance was limited to 100% of the "net income * * * from the property upon which the discovery was made." When the Revenue Bill of 1924 was

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[2]The explanation and reasons for this sharp distinction are discussed elsewhere herein.

pending, Mr. A. W. Gregg, then Special Assistant to the Secretary of the Treasury and later General Counsel for the Bureau of Internal Revenue, prepared, for the use of the Committee of Finance, a Statement of Changes made in the Revenue Act of 1921 by H. R. 6715.[3] The following pertinent statement appears on page 15:

> "The existing law limits discovery depletion to the *operating profit* from the property upon which the discovery is made. The bill limits discovery depletion to 50 per cent of the *operating profit* upon which the discovery has been made. Experience in administering the law has shown that the limitation imposed by the existing law is not a sufficient limitation, and it has been concluded that 50 per cent of the *operating profit* from the property represents a fair limitation upon discovery depletion."

Obviously, development expenditures—the cost of *getting ready* for production which frequently is never obtained—are not part of the *operating* expense of *producing* oil and are, therefore, not to be reflected in "operating profit."

Again, the report of the Senate Committee on Finance in connection with the Revenue Bill of 1924 contains the following statement:[4]

> "The exception contained in subdivision (c) supersedes the second and third provisos of

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[3]See Gregg Statement of Changes Made in Revenue Act 1921 by Treasury Draft and Reasons Therefor, found in Klein, Federal Income Taxation, Appendix, p. 308.

[4]Senate Report No. 398, 68th Congress, First Session, p. 20.

section 214 (a) (10) and 234 (a) (9) of the existing law. The existing law limits discovery depletion to the *operating profit* from the property upon which the discovery is made. The bill limits discovery depletion to 50 per cent of the *operating profit* from the property upon which the discovery has been made."

The Report of the Committee on Ways and Means on the Revenue Bill of 1924 (H. Rep. No. 179, 68th Congress, First Session, p. 18) is to like effect.

In the 1926 Act Congress abandoned depletion based on discovery value and substituted percentage depletion, so-called. Notwithstanding this radical change, Congress nevertheless retained, as a *limitation* on percentage depletion, the identical language of prior Acts with respect to the limitation on discovery depletion. See Report of Committee on Ways and Means on Revenue Bill of 1926 (H. Rep. No. 1, 69th Congress, First Session, p. 6):

> "The discovery depletion deduction limitation of an amount not in excess of 50 per cent of the net income of the taxpayer from the property upon which the discovery was made, provided in existing law, is *retained* in this provision."

Report of Senate Finance Committee (S. Rep. No. 52, 69th Congress, First Session) contains a similar statement at page 17. The Conference Report (H. Rep. No. 356, 69th Congress, First Session) contains a similar statement at page 32.

Never in any Regulation or Treasury Decision adopted prior to February 15, 1929, did the Treasury

suggest that a meaning be assigned to "net income from the property" different from that which had been consistently applied in the administration of the Revenue Act of 1921 and subsequent Acts. There is, therefore, nothing in this record to suggest that Congress, on May 29, 1928, intended the phrase to have a radically different meaning from the approved meaning of *identical* language as used in three prior Acts. On the contrary, the Committees of Congress had the depletion provisions called particularly to their attention in drafting the 1928 Act. The House Bill made no change in existing law with respect to either depreciation or depletion.[5] But the Senate Bill made changes, in which the House later concurred,[6] to "amend and clarify" the law governing the manner in which the deductions for depreciation and depletion shall be apportioned as between life tenant and remainderman or trustee and beneficiary. If Congress, in 1928, had not been satisfied with the Treasury's long-continued interpretation of "net income from the property", is it not reasonable to assume it would have amended the statute?

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[5]See statement to that effect in Senate Finance Committee Report (S. Rep. No. 960, 70th Congress, First Session, p. 20). Appendix, *infra*, p. 61.

[6]Conference Report on the 1928 Revenue Bill (H. Rep. No. 1882, 70th Congress, First Session, p. 11), Appendix, *infra*, p. 62.

II. The Treasury Construction of the Earlier Revenue Acts Was Correct. For the Same or Greater Reasons Its Regulations Under the 1928 Act Are Wrong.

If the considered construction and administration adopted by the Treasury in 1921, G.C.M. 2315, *supra*, cannot be said to have been clearly right as an original proposition, certainly it cannot be said to have been clearly wrong. The situation here in this respect is like that involved in *Helvering v. Reynolds Tobacco Co.*, 306 U. S. 110. This Court recognized, as did the Court below, that the question in the *Reynolds* case was "at least a debatable" one and that the statute was "so general in its terms as to render an *interpretative* regulation appropriate." Certainly, by comparison, the *original* Treasury interpretation involved in the *Reynolds* case was far more debatable than the Treasury's 1921 interpretation of "net income from the property."

Whether clearly right or merely fairly debatable, Congress, in 1924, knew of the administrative practice and approved of it. In view of the legislative history discussed above, it is clear that at least by May 29, 1928—date of approval of the statute applicable here—the meaning of "net income from the property" had been made "plain" and thus we have a situation which comes squarely within the doctrine of *Biddle v. Commissioner*, 302 U. S. 573, 582, where this Court said:

> "Where the law is plain the subsequent reenactment of a statute does not constitute adoption of its administrative construction. Iselin v. U. S.,

270 U. S. 245 * * *; Louisville & N. R. Co. v. U. S., 282 U. S. 740 * * *; Helvering v. New York Trust Co., 292 U. S. 455 * * *."

As the Commissioner's brief points out (p. 12), this Court has held that the term, "gross income from the property," to which the 27½% factor is applied, means the "gross income from the oil and gas." *Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312, 321. Clearly it does not embrace items of income such as interest on bonds owned by an oil company. Hence the term is not synonymous with the shorter, but nevertheless more inclusive, term, "gross income," as used in Section 22. This being so, "net income from the property" necessarily cannot be synonymous with the *taxable* "net income" of Section 21.

The term, "net income from the property" is correlative with the term, "gross income from the property," used in the same sentence. If the latter means "gross income received from the *operation* of the oil and gas wells by one who has a capital investment therein—not income from the *sale* of the oil and gas properties themselves," *Helvering v. Elbe Oil Land Development Co.*, 303 U. S. 372, 376, "net income from the property" must necessarily reflect only such deductions as relate to the *operation* of the wells in the *production* of oil and gas. Development expenditures are made *before* the period of operation and production begins—and unfortunately, in many instances, without ever reaching the stage of production. Therefore, they can have no relation to "net income from the property."

III. The Commissioner's Argument Analyzed and Considered.

1. The percentage depletion provision permits the deduction of "an arbitrary allowance * * * without reference to cost." *U. S. v. Dakota-Montana Oil Co.*, 288 U. S. 459, 461.

The Commissioner argues (p. 8) that Congress, by allowing percentage depletion of oil and gas wells, has singled them out "for *favored* treatment." So also has Congress determined, as a matter of legislative policy, that gains from sale or exchange of capital assets shall be taxed at lower rates than, for example, interest on bonds or dividends on stock. But such *special* treatment does not authorize the taxing authorities to modify the congressional mandate. If the special provisions are applicable, they should and must be applied as Congress intended, whether or not the administrative authorities consider them "artificial."

The Commissioner suggests (p. 9) that the question had arisen years ago as to whether development expenditures "were deductible from gross income as business expenses or whether they were in the nature of capital outlays." Query, whether this was the question really considered—back in 1918[7]—or whether the real question was not whether, regardless of their character, the revenues would not be equally well served, over a period of years, if taxpayers were allowed, at their option, to deduct such expenditures in determining *taxable* net income? Support for this

[7]Cf. footnote 6, Commissioner's brief, p. 10.

view is lent by the requirement of consistency from year to year "for all subsequent years."

The option of deducting currently, when coupled with the condition that the same practice be followed "for all subsequent years", is not an unmixed blessing. As the Court of Claims, in *McDuffie v. United States*, 19 F. Supp. 239, 245, said:

> "True, in some instances the exercise of the option noted may not result advantageously to the taxpayer. That, however, is a matter to be anticipated in the exercise of the right. Plaintiff by capitalizing the expenses here involved could have obtained whatever advantages accrue from the same, but by pursuing the opposite course he obtained and indispensably made the items proper in determining the cost of the product on hand at the close of the taxable year. * * *"

The term "net income from the property" is not to be found in the 1918 Act. Under that Act, therefore, the terminology of the Regulations was unimportant. It mattered not, once the Commissioner and the Secretary had decided to permit optional treatment, how development expenditures were labelled. Hence, in Art. 223 of Regs. 45, under the 1918 Act—the first regulations granting the option—development expenditures were described as an "*operating* expense" if—but only if—a taxpayer chose to deduct them in computing taxable net income. As if the choice of methods in the tax return could determine the essential nature of such expenditures!

"Net income from the property" first appeared in Sec. 234 (a) (9) of the 1921 Act, as a *limitation* on discovery depletion. It thus became necessary to be more precise in the description of development expenditures; if they were "*operating* expenses", then obviously they should be deducted in determining "net income from the property," which was an *operating* concept. The Treasury having decided, G.C.M. 2315, *supra*, that these expenditures had no proper place in the computation of "net income from the property"—because they were incurred *prior* to the time of operation and production—naturally had to correct the inapt label used in the 1918 Regulations. It is significant that in Art. 223 of Regs. 62, under the 1921 Act, the term "*development* expense" was substituted for "*operating* expense." The change was obviously a deliberate one and has been continued to the present time.

The Commissioner's brief (p. 10) is unfair in seeking to convey the impression to this Court that this taxpayer was free to choose, in the taxable years 1929 and 1930, whether it would capitalize or deduct currently its development costs of those years. The fact is that the taxpayer was bound, by contract with the Commissioner, *cf. Ilfeld Co. v. Hernandez, supra*, to deduct these items in its 1929 and 1930 returns. [R. 53; Art. 223, Regs. 69; Art. 243, Regs. 74.] Contrary to the Commissioner's assertion (pp. 10-11), the taxpayer made no claim in its tax returns that they were capital outlays; it did, of course, deduct them in determining its *taxable* net income—exactly as it did in 1925 and, in accordance with its agree-

ment, has done every year since, when such development costs have been incurred. The taxpayer has thus been thoroughly consistent, but as much cannot be said for the conduct of the Commissioner.

2. The mere deduction of development costs in computing taxable net income does not, of course, change their nature. But even if such treatment converts them into "business expenses," they are nevertheless not expenses incurred in the *operation* of the wells in the *production* of oil and gas. *Cf. Helvering v. Elbe Oil Land Co., supra.* Hence they did not affect "net income from the property" any more in the taxable years 1929 and 1930 than in 1921, when the original Treasury construction was adopted after full consideration.

The Commissioner can hardly be serious (p. 11) in treating the taxable net income of Section 21 as the same thing (except for the depletion allowance itself) as the "net income from the property" of Section 114 (b) (3), especially in view of what this Court said in *Helvering v. Twin Bell Oil Syndicate, supra.*[8] If the taxpayer had owned some shares of stock of the Standard Oil Company, purchased with proceeds of oil previously extracted, and had sold them at a gain of $100,000, we may be sure the Commissioner would have imposed a tax on such gain—and rightly so, because it would have augmented the "net income" of Section 21. But would the Commissioner have permitted the taxpayer to include such gain in "gross income from the property" and take an *additional*

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[8]Compare, also, G. C. M. 5104, C. B. VII-2, p. 115.

depletion deduction of $27,500? Clearly not—and rightly so.

The Commissioner (p. 12) invokes the maxim, *expressio unius est exclusio alterius*. This maxim was held inapplicable for reasons adequately stated in Circuit Judge Garrecht's opinion in *Ambassador Petroleum Company v. Commissioner*, 81 F. (2d) 474 at 478-9. Its application was also successfully resisted by the Government in *Phipps v. Commissioner*, 91 F. (2d) 627, 629 (C.C.A.-10, 1937), certiorari denied, 302 U. S. 742, and *Hamersley v. U. S.*, 16 F. Supp. 768, 83 Ct. Cl. 687, certiorari denied, 300 U. S. 659, where a gift tax was sustained when applied to transfers by gift of Liberty Loan bonds which, by statute, were exempt,—

> "* * * from *all* taxation, *except* estate or inheritance taxes * * *."

The Solicitor General has evidently overlooked the successful argument to this Court by his eminent immediate predecessor in opposition to certiorari in *Hamersley v. U. S., supra* (No. 564, October Term, 1936). At page 9 of his brief, Solicitor General Reed said:

> "In the light of the history of the exemption clause, we submit that the insertion of the phrase 'except estate or inheritance taxes' added nothing to the exception granted and was not intended to broaden the scope of the exemption. Accordingly, there is no room for the application of the principle *expressio unius est exclusio alterius*, the purpose of which is primarily to resolve an ambiguity or doubt and not to require a construction of words which is contrary to their historical and

settled legislative meaning or which leads to an anomalous result. Cf. Shurtleff v. United States, 189 U. S. 311; Continental Bank v. Rock Island Ry., 294 U. S. 648, 677-678; Ford v. United States, 273 U. S. 593, 611-612; Holy Trinity Church v. U. S., 143 U. S. 457."

In the case of *Hatfield v. Commissioner*, 38 B. T. A. 245, 247, the Board held that the provisions of Section 22 (a) of the Revenue Act of 1934, providing for the inclusion in gross income of the salaries of "judges of the United States taking office after June 6, 1932," did not exempt, under the rule of *expressio unius*, the 1934 salary of a judge of the United States Court of Customs Appeals who took office in 1923. This opinion contains at page 247 an excellent discussion of the *expressio unius* rule, and clearly shows that it is not applicable here. One obvious reason for the parenthetical expression "(computed with allowance for depletion)" was doubtless the desire of Congress to simplify the *computation* of the *limitation* on the percentage depletion allowance itself.*

We agree with the Commissioner (p. 12) that the term "net income from the property" should be taken in its natural sense, but the conclusion drawn by the Commissioner merely begs the question here at issue.

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*If the Solicitor General disagrees, perhaps he will submit a formula for ascertainment of "net income from the property" computed *with* allowance for percentage depletion. Cf. *Edwards v. Slocum*, 264 U. S. 61, affirming 287 F. 651, where this Court referred with approval to the statement of Circuit Judge Hough: "We * * * hold that the presumption is that Congress intended a simpler method—one that a plain man could understand. Algebraic formulae are not lightly to be imputed to legislators."

For one thing, this Court may wish to inquire of the Commissioner how, if the construction now contended for by him is such a "natural" one, it completely escaped the Commissioner and the Secretary from 1921 to 1929. We say that development expenditures, which are incurred *prior* to operation of the well and production of oil and gas, have no more natural connection with "net income from the property" than the proceeds of sale of an oil well have a bearing upon or are includible in "gross income from the property". *Cf. Helvering v. Elbe Oil Land Development Co., supra.*

3. The Commissioner's argument (p. 12) suggests that his position is supported by "administrative practice of some *twelve* years' standing." The regulation in question was first adopted in 1929. That is the first of the two taxable years here involved. Theoretically at least, the true tax liability for 1929 should be ascertainable on December 31, 1929. Neither the Government's rights nor a taxpayer's obligations should be increased or lessened by reason of a ten-year delay in their *adjudication;* the appeal to the Board herein was filed July 28, 1932, more than seven years ago [R. 1].

The Commissioner fails to state that his present attempted practice represents an "about-face"[10] from

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[10]To borrow from Circuit Judge Swan in *Bliss v. Commissioner*, 68 Fed. (2d) 890, 893, affirmed *Helvering v. Bliss*, 293 U. S. 144.

the *original* considered Treasury practice adopted in 1921, which was thrice approved by Congress. In *Koshland v. Helvering*, 298 U. S. 441, the Commissioner relied upon "Treasury Regulations long in force." But although successive statutes had been enacted, without change in their language, this Court held that the regulations could not be given effect because the pertinent provisions of the statute were unambiguous and specific and the Secretary of the Treasury had no power to amend them. Compare, also, *Boca Ratone Co. v. Commissioner* (C.C.A.-3), 86 Fed. (2d) 9.

If "Treasury Regulations long in force" would not sustain the Commissioner in the *Koshland* case, it is obvious that he can expect no assistance from a regulation which was not promulgated for the first time until after the passage of the statute here involved. And especially is this so when that regulation is contrary to the *only* judicial interpretation of *identical* language in the 1926 Act.

Ambassador Petroleum Co. v. Commissioner, 81 F. (2d) 474, was decided February 5, 1936. The Commissioner allowed May 5, 1936 to pass without applying for certiorari. Nor did he ever litigate to the point of decision any other case under the 1926 Act. The Revenue Act of 1936 was not approved until June 22, 1936. If the Commissioner was dissatisfied with the decision in the *Ambassador* case, why did he

not attempt to convince Congress that it was wrong and have the rule changed in the 1936 Act?[11] The case at bar was decided by the Board on April 30, 1937 [R. 57] and by the Court below on April 1, 1938 [R. 79]. The Revenue Act of 1938 became effective May 28, 1938. Why did not the Commissioner attempt to get Congress to change the statute in 1938? If the Commissioner's construction of "gross income from the property", *approved* by this Court in *Helvering v. Twin Bell Oil Syndicate, supra,* justified the making of a "clarifying amendment" in the Revenue Act of 1932, where the administrative construction had been uniform and consistent, it would seem that the Commissioner, at the same time, should have asked Congress for an amendment, approving for the future, the construction he now seeks to impose on this taxpayer.

The Commissioner next contends (pp. 13-14) that if the change first made in 1929 may not be justified under the general power "to prescribe all needful rules

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[11]The Commissioner was dissatisfied with the decision in *Cole v. Commissioner,* 81 F. (2d) 485, decided December 20, 1935, by the same three judges who decided the *Ambassador* case. Yet he did the proper thing with respect to the rule of the *Cole* case; he went to Congress and got the statute changed, *but only for the future.* See the entirely new provision which appeared as Section 53(b) of the Revenue Act of 1938 and its legislative history as contained in Report on the Revenue Bill of 1938 by House Subcommittee on Internal Revenue Taxation, January 14, 1938. *Hassett v. Welch,* 303 U. S. 303, shows that he went to Congress because of dissatisfaction with the decisions of this Court in *May v. Heiner,* 281 U. S. 238, and *Burnet v. Northern Trust Co.,* 283 U. S. 782.

and regulations" (Section 62 of the Act of 1928), it may be sustained under the special power conferred by Section 23 (1), as shown in italics below:

> "*Sec. 23. (1) Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; *such reasonible allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary.* In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion in case of oil and gas wells, see section 114 (b) (3).)"

While respondent must concede that Section 114 (b) (3)—the arbitrary percentage depletion provision—is not to be read independently of Section 23(1)—the "reasonable allowance for depletion" provision—*Helvering v. Twin Bell Oil Syndicate*, 293 U. S. 312,[12] nevertheless it may be doubted, in view of the context

[12] A case not cited in the Commissioner's brief.

and statutory history of Section 23 (l), whether the regulatory power specially conferred therein extends to the percentage depletion allowance. However this may be, this special power certainly would not authorize the Commissioner to change, by regulation, the plain meaning of Section 114 (b) (3). It would not authorize him to rule, for example, that in the case of oil property held by one person for life with remainder to another person, the depletion deduction shall be apportioned (as in the case of a trust) when Section 23 (l) expressly requires that the entire deduction shall be allowed to the life tenant. Certainly, also, this special power, if applicable to Section 114 (b) (3), would not justify a regulation providing, for example, that the percentage depletion allowance shall be 15% of the "gross income from the property" but shall not exceed 25% of the "net income from the property." For this Court to permit the Commissioner, by regulation, to change the measure of "net income from the property" from time to time, especially in the radical manner which he is attempting here, would be to approve a result equally as contrary to the intention of Congress on May 29, 1928, as though the Commissioner had, by regulation, attempted to change the percentage factors themselves.

The Commissioner argues (p. 14) that regulations made pursuant to Section 23 (l) are "*legislative* in character rather than purely interpretative." He cites no authority for that position. For its refuta-

tion, we need look no further than *Manhattan General Equipment Company v. Commissioner*, 297 U. S. 129, 134, where this Court said:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law, *for no such power can be delegated by Congress*, but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. Lynch v. Tilden Produce Co., 265 U. S. 315, 320, 322, 44 S. Ct. 488, 68 L. Ed. 1034; Miller v. United States, 294 U. S. 435, 439, 440, 55 S. Ct. 440, 79 L. Ed. 977, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, *but it must be reasonable*. International R. Co. v. Davidson, 257 U. S. 506, 514, 42 S. Ct. 179, 66 L. Ed. 341. * * *."

But even if it be conceded that the special power of Section 23(l) be legislative in character, the Commissioner had the same statutory authority under the earlier revenue acts and his power to legislate in a way diametrically opposed to his original construction was cut off by Congressional approval, in 1924, 1926 and 1928, of the original regulations and practice. Any other holding by this Court would authorize the Commissioner to adopt legislative regulations directly in conflict with a statutory provision, rather than carrying out the intendment of the statute.

The Board and the Court below held the regulation invalid not because they differed with the Commis-

sioner's "exercise of discretion," as he asserts (p. 15), but because the regulation, first promulgated after the enactment of the statute applicable here, conflicted with the intention of Congress as clearly disclosed by the legislative history of the statute and two prior statutes.

Biddle v. Commissioner, supra, is a complete answer to the Commissioner's argument (p. 15) as to the effect of the enactment of the Revenue Act of 1932 and subsequent Acts. None of the cases cited by the Commissioner (p. 15) supports his position here. The Government prevailed in all but one of the cases cited, but in all of these the administrative construction was not only long-continued, but was uniform. *Hassett v. Welch,* 303 U. S. 303, which the Government lost, involved, as here, an attempted "about-face" from an earlier Treasury construction of an earlier but similar statute. This decision, therefore, supports the position of the respondent here, as does *Brewster v. Gage,* 280 U. S. 327, 337, where this Court indicated that it did not approve of a reversal of administrative construction, particularly where, as here, it "would be likely to produce inconvenience and result in inequality."

We have no quarrel in principle with the Commissioner's assertion (p. 15) that the rule as to the effect of reenactment of statutes without change applies with equal force where the taxable year precedes the reenactments and is governed by the *original* statute rather than where it is governed by one of the reenacting statutes. But the "original statute" with which we are concerned is the Revenue Act of 1921, where the term "net income from the prop-

erty" originated. For example, the enactment of the Revenue Act of 1924 had a dual effect; (1) it *approved* the Treasury construction of the Act of 1921; (2) it *adopted* that construction as the meaning to be given to identical language in the Revenue Act of 1924. When Congress, in 1926, made the radical change from discovery to percentage depletion and expressly said[13] that—

> "* * * The provision of *existing* law *limiting* this amount to an amount not in excess of 50 per cent of the net income of the taxpayer from the property is *retained*."—

it adopted, for the second time, the original, uniform and consistent Treasury construction of the Acts of 1921 and 1924. That the Commissioner must have believed this was so is shown by the fact that Reg. 69, under the 1926 Act, made no attempt to change the construction which had been in effect since 1921. Not until 1929 did he, most belatedly, get the idea that the change from discovery to percentage depletion required him to change the meaning of the *limiting* formula. And even then it was not consistent, for he made no attempt to change the regulations covering the years 1925, 1926 and 1927, governed by the 1926 Act.

4. The Commissioner erroneously urges (p. 16) that the practical effect of the decision below is to permit a double deduction for the same expenditure, since the taxpayer immediately secures a deduction

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[13]House Report No. 356—Conference Report, 69th Congress, 1st Session, p. 32.

of 100 per cent of the development costs (which is true, provided the taxpayer has any income from other sources in the particular year), *plus,* says the Commissioner—

> "a further deduction when the sum is excluded from depletion computation."

There are several answers to this contention.

(a) The alleged "further" deduction arises, not because development costs are excluded from the computation, but because the clear command of the statute is that the taxpayer shall have an alternative deduction equivalent to 27½% of the "*gross* income from the property", subject only to the privoso that it shall not exceed 50% of the "net income from the property." Thus the only question is whether the deduction, based primarily on *gross,* shall be *cut down* by including the development costs in the computation of the *net.* The deduction may never, in any case, exceed 27½% of the gross.

It may be stated as a rule of *universal* application that the exclusion of development costs, pursuant to the decision of the Court below, will not serve to enlarge the percentage depletion *unless* the taxpayer's expenditures on "the property," *including* development costs, exceed 45% of the "gross income from the property." And in those cases where development costs serve to bring the expenditures on "the property" to more than 45% of gross income, the depletion allowance is cut down by *only one-half* of the *excess* over 45% of gross. In other words, if the development expenditures were, say, $10,000, their exclusion from the computation might, in a

given case, increase the depletion allowance by any figure between *one-half cent* and $5,000, but such exclusion could in no case serve to increase the amount deductible to more than 27½% of the "gross income from the property."

Applied to the case at bar, let us examine the figures at page 26 of the Commissioner's brief. Under his theory, the taxpayer gets no percentage depletion allowance whatever, although oil worth $370,448.72 was extracted from the properties. Under the rule of the Court below, the taxpayer gets a deduction of $42,528.91, which is 11.4% of the gross income from the property, as compared with the upper limit of 27½%, which would be $101,873.40.

The taxpayer did, of course, get a deduction, in determining *taxable* net income, of the amount of its *development* costs, namely, $279,927.04, because it complied with its 1925 promise.[14] The Commissioner complains that the taxpayer should not get a "double deduction," yet we find that $42,528.91 is approximately 15% of $279,927.04—far, we submit, from a double deduction.

(b) The result which the Commissioner chooses to label a "double deduction" arises directly from the option, granted since 1918, to deduct development costs in computing *taxable* net income and the propriety of which is not in issue here. To illustrate:

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[14]If taxpayer had sold these properties subsequent to development, say in 1931, the Treasury would have benefited from the deduction taken in 1930 because the $279,927.04 would have been wholly excluded from the cost basis in computing gain. *Ramsey v. Commissioner*, 66 F. (2d) 316.

Frequently development costs, or the major portion of them, are incurred prior to the taxable year in which production begins. If an operator in such circumstances has income from other sources, these development costs will be deducted in full from this income. Then, in the next year and the succeeding years in which production is secured, the Commissioner must admit that these prior-year development costs will not be taken into consideration in computing the depletion limitation.

To illustrate further: Suppose an oil operator, in the early part of his taxable year, spends $25,000 in development costs. Then, in the later portion of the same year—after the well has been brought in—he incurs *production* expense of $20,000 in producing a gross income from the property of $100,000. Even if the Commissioner's views were applied, the "net income from the property" would be $55,000 and 50% thereof, or $27,500, would exactly equal 27½% of the $100,000 gross. It is obvious, therefore, that the rule for which the Commissioner contends will not obviate the result of which he complains except in those cases where the cost of development, added to the cost of production, bears a high ratio to the oil recovered. Thus the Commissioner's rule hits only those operators least able to bear its burden.

(c) Assuming the Commissioner's characterization of "double deduction" were apt, which we deny, the question immediately arises whether it was not equally true under the prior acts, beginning with the Act of 1921. If so, why did it take the Commissioner eight years to discover it? Indeed, it was even more true under the 1921 Act, which contained a limitation of

100% of the "net income from the property," than under the 1924 Act and all subsequent statutes, where the limitation is 50%. This is obvious from the figures at page 26 of the Commissioner's brief—if the limitation were 100%, the Court below would have allowed a depletion deduction of $85,057.82 instead of $42,528.91.

5. As we read the Commissioner's argument (p. 17), he clearly asserts that *both* the earlier statutes *and* the regulations thereunder are "quite different" from the Revenue Act of 1928 and the regulations thereunder. This assertion is true only in minor part. The regulations, we admit, are "quite different," but the *pertinent* portion of the Act of 1928—the *limiting* formula of "net income from the property"—is *identical* with similar language in the Acts of 1921, 1924 and 1926.

Even if the Commissioner adheres, at the oral argument, to the erroneous assertion just mentioned, he must concede that there was no difference whatever between the pertinent provisions of the Acts of 1926 and 1928. Will he cite to this Court any article of Regs. 69, under the 1926 Act, which in any way resembles Art. 221(i) of Regs. 74, the validity of which is at issue here? Taxpayer knows of no such Regulation and the Commissioner's failure to issue proper Regulations under the 1926 Act can hardly strengthen his position here. Quite the contrary, in view of the Regulations under the Acts of 1921 and 1924.

The Commissioner's description (p. 19) of the decision of the Court below is not correct. The lower Court did not concede that the provisions of the

1928 Act were different from those of earlier statutes. Neither did the Court concede, any more than we do, that the Regulations issued in 1929 were "prospective only." Does the Commissioner assert that these Regulations, promulgated for the first time February 15, 1929, were not attempted to be applied to the year 1928? If so applied, would they still be "prospective only"? Will the Commissioner deny that many oil operators incurred development costs during 1928 and deducted them in determining taxable net income for that year only because they were bound to do so by reason of an election made under Art. 223 of Regs. 69? Will the Commissioner deny that he is holding taxpayers to an election made long before his new Regulation was promulgated on the faith of a diametrically opposite administrative construction? How, then, may it *fairly* be said that the 1929 Regulations are prospective only?

The real issue in this case appears from an examination of paragraph (a) on page 19. If this Court agrees with the Commissioner's sweeping contentions there stated, and further agrees that the 1929 Regulations were prospective only, as applied to this taxpayer, then it will presumably reverse the Court below.

The Commissioner asserts (p. 19) that the statute itself, Sec. 605 of the Revenue Act of 1928, gives the Commissioner the power to issue new regulations which may change the law. Such a contention was rejected in *Helvering v. Reynolds Tobacco Co.*, 306 U. S. 110, where this Court said:

> "* * * It is clear from this provision that Congress intended to give to the Treasury

power to correct misinterpretations, inaccuracies, or omissions in the regulations and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. The question is whether the granted power may be exercised in an instance where, by repeated reenactment of the statute, Congress has given its sanction to the existing regulation.

"Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed. * * *."

Furthermore, the attempted change in the regulations here involved actually has a clear retroactive effect, as applied to this taxpayer, and withdraws one of the important inducements offered by the Treasury in connection with the contract made in taxpayer's return for the year 1925. Nothing like this situation was present in either *Morrissey v. Commissioner*, 296 U. S. 344, or *Murphy Oil Co. v. Burnet*, 287 U. S. 299, cited by the Commissioner at page 20.

Morrissey v. Commissioner is readily distinguishable. The decision in *Crocker v. Malley*, 249 U. S. 223, involving the application of the 1913 Act to "associations," was rendered in March, 1919. The Treasury thereafter issued its Regulations under the 1918 and 1921 Acts consistently with the decision in *Crocker v. Malley*, but, apparently, without noting or observing that the pertinent language of the 1913

Act was narrower in its scope than the somewhat comparable language of the 1918 and 1921 Acts. Not until the case of *Hecht v. Malley*, 265 U. S. 144, was decided in May, 1924, did the Treasury realize the distinction between the scope of the 1913 and 1916 Acts, on the one hand, and the 1918 and 1921 Acts, on the other.

In drafting its Regulations under the 1924 and 1926 Acts, applicable in *Morrissey v. Commissioner*, the Treasury made them conform to *Hecht v. Malley*. In deciding the *Morrissey* case this Court said that Regulations may be "*clarified* or *enlarged* so as to meet administrative exigencies or *conform* to judicial decision." Most assuredly, Regulations may be revised, but the Commissioner has failed to cite any authority to the effect that Regulations may be changed in a manner that makes them *inconsistent* with the statute. Regulations 74 are concededly inconsistent with the prior administrative interpretation of the earlier Acts and with the meaning of the 1926 Act as expounded in the *Ambassador Petroleum Co.* case. How, then, can they be otherwise than inconsistent with identical language of the 1928 Act unless it be shown that the Congress which enacted the 1928 Act intended the phrase to be given a meaning diametrically opposed to that which was adopted by the Congress which passed the 1926 Act? The Commissioner's brief fails to furnish a satisfactory answer to this question—and it is clear that there can be no such answer.

Murphy Oil Co. v. Burnet, supra, likewise does not support the Commissioner. It involved the taxable years 1919 and 1920. The *original* regulation,

construing the applicable Revenue Act of 1918, was Art. 215 of Treasury Regs. 45 (1920 Ed.). It is well known that tax cases for the years 1919 and 1920 were not settled for many years, being kept open by waivers of the statute of limitations and claims for refund. While these years were still open, the Treasury, in 1926, amended Art. 215 of Regs. 45. True, in the meantime, the Revenue Acts of 1921, 1924 and 1926 had been enacted. The original regulation, as issued in 1920, was not only clearly wrong (as applied to situations where the sum of a bonus and expected royalties exceeded the lessor's capital investment in the oil in ground) but the retroactive amendment thereof, issued in 1926, prevented the harsh results which the original regulation—if valid—would have imposed on certain lessors. It was thus not only corrective but ameliorative also. To illustrate: If, for example, the lessor's capital investment were $500,000, the bonus were $1,000,000, and the estimated royalties were $2,000,000, the lessor would have had to report, under the 1920 Regulation, $500,000 of the bonus as return of capital, the *entire* balance as income in the year of receipt, and would have had no depletion allowance against the royalties when received in subsequent years. The 1926 amendment was far more reasonable because it provided for an allowance for depletion in every year during which the oil was extracted.

On the facts shown of record in the *Murphy Oil* case the result was the same under either the original Regulation or the 1926 amendment thereof. Certainly the decision is not authority for allowing the Commissioner to issue a regulation in defiance of

the plain meaning of a statutory provision of eight years' standing. After all, "not only must a regulation, in order to be valid, be consistent with the statute, *but it must be reasonable.*" *Manhattan General Equipment Co. v Commissioner, supra.* Certainly, Art. 221(i) is not reasonable as applied to this taxpayer or any other who made an election prior to the change.

The Commissioner's argument (p. 21), in referring to the Revenue Act of 1928, utterly and incorrectly disregards the fact that, so far as material here, it was merely the reenactment of a statute originally enacted in 1921. The Commissioner's argument, not the holding of the Court below, is the one which leads to an "extraordinary conclusion," namely, that the mere reenactment of a tax statute, using the identical language of three prior Acts, empowers the Commissioner to disregard the plain meaning of the statutory language. House Report No. 356, 69th Congress, 1st Session, pp. 31-32, asserts that percentage depletion was being substituted for discovery depletion "in the interest of simplicity and certainty of administration * * *." How could there ever be any certainty as to the meaning of taxing statutes if this Court were to approve the proposition advanced by the Commissioner?

The Commissioner suggests (p. 22) that the instant case is sharply to be distinguished from *Helvering v. Reynolds Co., supra.* On the contrary, we submit that it is not fairly distinguishable and that the reasoning of the *Reynolds* case requires the affirmance of the decision of the Court below.

In the *Reynolds* case, as in the instant case, the question involved related to the construction of the Revenue Act of 1928—in short, what was meant by the statutory language on May 29, 1928, the date on which the Act of 1928 was approved?

Each case involved an *attempt* by the Commissioner, by regulation, to *change* the meaning which had been consistently given to identical language in revenue acts prior to the Act of 1928. In the present case, this attempt occurred nine months after the approval of the Act of 1928, while in the *Reynolds* case the attempt did not occur for nearly six years, viz., May 2, 1934.

In the *Reynolds* case the Commissioner argued that because Congress reenacted Section 22 (a) in the Revenue Acts of 1936 and 1938, it approved the *amendment* of May 2, 1934 to Art. 66 of Regs. 74 (promulgated under the 1928 Act). This Court held that the passage of the 1936 and 1938 Acts did not have such an effect; that the taxpayer's liability for 1929 "is to be determined in conformity to the regulations then in force." This Court's reason for this holding is stated in the first sentence of the concluding paragraph of its opinion: the reenactment of Section 22 (a) in the Act of 1928 amounted to legislative approval of the *predecessors* of Art. 66 of Regs. 74, construing the *predecessors*, in the 1926 and earlier Acts, of Section 22 (a) of the 1928 Act.

By similar reasoning it must, we submit, be held in the present case that when Congress employed the term, "net income from the property," in Section 114 (b)(3) of the 1928 Act, it intended that it should

be given the same meaning as identical language in the Acts of 1921, 1924 and 1926, *especially* when the reports of the Committee on Ways and Means and the Senate Finance Committee show that Congress specifically approved the *original* administrative construction.

This Court, in the *Reynolds* case, referred to the suggestion of the Second Circuit in a similar case, *Squibb & Sons v. Helvering*, 98 F. (2d) 69, 70, that the alteration of the "existing" rule—that is, the rule prior to the attempted amendment—"requires a legislative declaration." It then stated that this was a question which it "need not now determine." It then added—

> "It may be that by the passage of the Revenue Act of 1936 the Treasury was authorized thereafter to apply the regulation in its amended form. But we have no occasion to decide this question since we are of opinion that the reenactment of the section, without more, does not amount to sanction of retroactive enforcement of the amendment, in the teeth of the former regulation which received Congressional approval, by the passage of successive Revenue Acts including that of 1928."

The language just quoted might well, it would seem, be adapted to the instant case merely by substituting the words, "Revenue Act of 1932" for the words, "Revenue Act of 1936." This, in effect, is what Judge Denman said in his opinion in the instant case. [R. 75].

In *National Home Owners Service Corp. v. Commissioner*, 39 B. T. A. 753 (No. 101), the Board of Tax Appeals had to consider whether Treasury Decision 4430, promulgated May 2, 1934, could be applied in determining tax liability for the years 1934 and 1935. The Board observed that the final changes in the Revenue Bill of 1934 were agreed to by both Houses on May 3, 1934, one day after issuance of T. D. 4430, but that the legislative history did not indicate that T. D. 4430 was brought to the attention of Congress. The Board then stated that the question was whether, since Congress had given the old administrative construction the force of law, "the Commissioner could *change* the law by amending his regulation or whether a change in the law would have to come from the legislature. *Cf. Squibb & Sons v. Helvering*, 98 Fed. (2d) 69." After thus stating the question—which is precisely the same as in the case at bar—and after quoting in full the last two paragraphs of the opinion in the *Reynolds Tobacco* case, the Board said:

> "The above quotation rather indicates that the Supreme Court agreed with Judge Learned Hand who said in the *Squibb* case that only legislative enactment could change the well established rule of law, and that there was no change, at least until 1936. Even then the Commissioner could not point back to consistent regulations on the subject. We hold that the Treasury Decision of May 2, 1934, is not applicable in the present case and the petitioner realized no gain from the transactions of 1934 and 1935. * * *"

If the amended regulation in the *Reynolds* case, issued in 1934, could not change the law except possibly beginning in 1936, it is submitted that Art. 221 (i) of Regs. 74 cannot change the law for any year prior to 1932, which was the first revenue statute enacted subsequent to the issuance of the new regulation. Although the construction of the Revenue Act of 1932 is not involved in the case at bar, it may well be that this Court, in No. 26, *F. H. E. Oil Company v. Commissioner*, set for argument immediately following the instant case, may have occasion to decide what, if any, bearing the issuance of the new regulation in 1929 had on the construction to be given to the Act of 1932.

The Commissioner suggests (p. 22) that the new regulations were "foreshadowed" by G. C. M. 2315. This ruling appears in Cumulative Bulletin VI-2, which shows on its front cover that it contains rulings of the Bureau of Internal Revenue made during the months of July to December, 1927. Obviously it could not have been printed by the Government Printing Office until sometime in 1928. Also on the front cover of that Cumulative Bulletin are the following statements:

> "SPECIAL ATTENTION is directed to the cautionary notice on this page that published rulings of the bureau do not have the force and effect of Treasury Decisions and that they are applicable only to facts presented in the published case
>
> * * * * * * * *
>
> "The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opin-

ion in the administration of the Bureau of Internal Revenue; the rulings other than Treasury Decisions have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury. Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case rests. It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical with those of the reported case. As it is not always feasible to publish a complete statement of the facts underlying each ruling, there can be no assurance that any new case is identical with the reported case. As bearing out this distinction, it may be observed that the rulings published from time to time may appear to reverse rulings previously published."

G. C. M. 2315 shows on its face that the only opinion *requested* of the General Counsel related to the Act of 1921. After reciting that the consistent Bureau practice under the 1921 and 1924 Acts had been not to require development costs to be reflected in the computation of "net income from the property," the author proceeded gratuitously to suggest that a like interpretation should not be given to the Act of 1926, even though the pertinent language was identical with that of the Acts of 1921 and 1924. As in so many instances where advice is volunteered, the author's conclusion as to the 1926 Act was based upon a premise so obviously unsound that, before many months had elapsed, the General Counsel had to con-

cede error—cf. G. C. M. 5104, C. B. VII-2, p. 115. That unsound premise was that "net income *from the property*," as used in Section 204 (c)(2) of the Act of 1926—the percentage depletion provision—"should be taken to mean the net income defined in sections 212 and 232 of the Act"—the *taxable* net income provisions.

By express notice and reservation, G. C. M. 2315 "did not commit the Department."[14a] Obviously, therefore, it was a ruling which was neither binding on the respondent nor one with notice of which it was chargeable. Cf. *Helvering v. New York Trust Co.*, 292 U. S. 455, 468.

The proper place for the Commissioner to have "foreshadowed" the change made in 1929 was in Regs. 69, promulgated in August, 1926, under the Revenue Act of 1926. Had he done so, a contention that the change was required by the substitution of percentage for discovery depletion, might have possessed more force.[15] Failing that, the Commissioner should have amended Regs. 69 as originally issued—something he has never done down to the present date. Certainly T. D. 4025, C. B. VI-1, p. 75, approved by the Secretary on June 18, 1927, should have contained

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[14a] A survey of Prentice-Hall Federal Tax Citator Service, pages 2511-2624, 3559-3591, and 4190-4196, discloses that 103 G. C. M.s have been revoked and 137 modified by subsequent Treasury rulings. See, also, C. C. H. 1939 Standard Federal Tax Service, Index Volume, pages 18,031-18,047.

[15] We have, however, shown elsewhere that in changing to percentage depletion the *limitation* formula was expressly "retained."

notice to taxpayers if the Commissioner and the Secretary believed that the shift to percentage depletion required a change in the settled meaning of "net income from the property.". That Treasury Decision reads as follows:

"To Collectors of Internal Revenue and Others Concerned:

"Under the provisions of article 223, Regulations 69, such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of oil and gas property, drilling of wells, building of pipe lines, and development of such property, may at the option of the taxpayer be deducted as a development expense or charged to capital account. The regulations promulgated under the Revenue Acts of 1918, 1921, and 1924 provide for the same option.

"In view of the change in the basis for depletion provided by the Revenue Act of 1926, in the case of oil and gas wells, taxpayers may make a new election as to the treatment of the expenditures above mentioned for taxable periods ending on or after January 1, 1925, but not later than six months after the date of this decision. Taxpayers desiring to make a new election are required to file amended returns for the taxable periods involved within six months from the date of this decision.

C. R. NASH
Acting Commissioner of Internal Revenue.

Approved June 18, 1927.

A. W. MELLON
Secretary of the Treasury."

The only fair conclusion to be drawn from the fact that T. D. 4025 contained no notice whatever of any projected attempt to change the meaning of "net income from the property" is that by June 18, 1927—sixteen months after the passage of the Act of 1926—the alleged necessity for change had not then occurred to the responsible officials of the Treasury.

The undue length of time that it took for the Treasury officials to "discover" the new meaning is itself a factor to be weighed in determining its correctness, for as this Court, in *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 370, said:

> "the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and study of an acute and powerful intellect would discover."—

a statement that is particularly applicable to the percentage depletion provision, which this Court has said is a "rule of thumb" and must be "applied without a detailed examination of the facts affecting each taxpayer" in "the simple manner it contemplates." *Helvering v. Mountain Producers Corp.*, 302 U. S. 681.

It is difficult to perceive how the petitioner's position here is aided by his admission (p. 23) that under the Act of 1926 "the Commissioner made no ruling as to the meaning of the term 'net income'[16] as applied to

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[16]Here, as elsewhere, the Commissioner fails to use the correct statutory language: "net income *from the property*."

percentage depletion of oil and gas properties." The important fact is, as he admits (p. 23), that his "first official ruling" was made under the Revenue Act of 1928 "and is the very one under attack in the instant case."

On page 24 the Commissioner makes a half-hearted concession which disregards the consistent construction which G. C. M. 2315 concedes was given by the Treasury to its own Regulations under the Acts of 1921 and 1924. He refers to the "legislative history" of the 1921 Act and contends that this shows that the original meaning assigned by the Treasury to "net income from the property" was wrong. Respondent concedes that the purpose which Congress had in mind in 1921 in placing a limitation on discovery depletion of 100% of the "net income from the property" was to avoid for the future the result which occurred under the Act of 1918, whereby the unlimited deduction for discovery depletion might absorb not only income from oil and gas but other income of a taxpayer as well. The Commissioner's conclusion drawn therefrom is, however, erroneous. He contends (pp. 25-26) that by deducting development costs in the computation of *taxable* net income the respondent, in 1930, not only eliminated all taxable income *from the four properties involved*, but also obtained the benefit of a $194,869.62 loss. But the Commissioner overlooks the true situation. The development costs of $279,927.04 are not deducted from the gross income from

the properties, but from all the taxpayer's income from all sources. And this was done because of the taxpayer's contract with the Commissioner, made when the taxpayer filed its 1925 return, that it would deduct such costs "for all subsequent years." Furthermore, the *result* of which the Commissioner complains flows from the option, not from the construction of "net income from the property."

The colloquy referred to by the Commissioner (p. 27) indicates nothing more than in the opinion of Senator Jones, of New Mexico, the option, which had been in effect since 1918, should be abolished and taxpayers in the oil business should all be required to charge development costs to capital account. Apparently the Treasury did not share the views expressed by Senator Jones, for the option has been continued in effect down to the present time without disapproval by Congress. The question was not whether development costs were an *operating* expense or a *development* expense, and it is not clear that Mr. Manson was attempting to draw any distinction on this basis. Cf. Art. 243 of Regs. 74, Commissioner's brief, p. 31, where they are described as "development" expense.

6. There is nothing in the taxpayer's position conflicting with *Ramsey v. Commissioner*, 66 F. (2d) 316, and other cases cited on pages 27 and 28 of the Commissioner's brief. Those cases merely hold that intangible drilling and development costs charged off cannot later be treated as a part of the cost of the

property upon a sale. That is the very reason why, after one has elected to charge them off upon the faith of a promise that they will not be used in computing the depletion allowance, and is thereby prevented from capitalizing these costs and getting the benefit of them otherwise, the taxing authorities should not be permitted to change their position. This Court has said, *Helvering v. Mountain Producers Corp., supra,* that asserted equities should not control the construction of the depletion limitation provision, but here the Commissioner asserts equities in his favor which, when they are examined, are found to work the other way.

The statement of the Commissioner (p. 29) that the taxpayer has enjoyed the "advantage" of deducting development expenditures from taxable gross income is only partially true. It falls far short of describing the price paid by the taxpayer for this "advantage," if indeed it may ever be determined that such it is. In the first place, as noted, the taxpayer is deprived of the advantage of counting such expenditures as cost in the event of sale, and is also prevented from including them in the basis for computation of cost depletion. Furthermore, if the Commissioner's contentions are sustained in this case, it will mean that for the year 1930, the taxpayer will get no depletion deduction whatever—cost or percentage—on any of the four properties in question [R. 52, last line], even though it is admitted that its

oil reserve—its capital in the ground—was depleted during 1930 by the extraction of oil worth $370,448.72 (Commissioner's Brief, p. 26).

In the Circuit Court of Appeals both parties relied on *U. S. v. Dakota-Montana Oil Co.*, 288 U. S. 459. Though not mentioned in its opinion in the instant case, it is clear, from the decision in the *Ambassador Petroleum* case, that the Ninth Circuit agreed that it favored the position of the taxpayer. In the *Dakota-Montana* case, this Court said (p. 466):

> "Thus the acts of 1918, 1921, and 1924 were *consistently* construed by the regulations to permit a depletion, but not a depreciation allowance for the costs of development work and drilling, which were treated for this purpose either as a part of the cost or an addition to the discovery value of the oil in the ground. The administrative construction must be deemed to have received legislative approval by the re-enactment of the statutory provision, without material change. (Cases cited.)"

By way of paraphrase, the respondent submits that the acts of 1921, 1924 and 1926 were *consistently* construed by the regulations as not requiring the deduction of development costs in determining "net income from the property"; and that *this* administrative construction must be deemed to have received legislative approval by the reenactment, in 1928, of the statutory provision, without material change.

IV. Helvering v. F. H. E. Oil Company, 102 F. (2d) 596, Is Unsound or at Least Is Distinguishable Since It Involves a Statute Enacted After the Challenged Regulation Was First Adopted.

The Commissioner's brief herein does not even cite the decision of the Circuit Court of Appeals for the Fifth Circuit in *Helvering v. F. H. E. Oil Co.*, 102 F. (2d) 596. The reason for this omission may be that the Commissioner believes that case is distinguishable from the case at bar for reasons suggested in the decision in *Helvering v. Reynolds Tobacco Co., supra*, since it involves a statute enacted subsequent to the first promulgation of the regulation here involved.

However that may be, Circuit Judge Foster, speaking for the Fifth Circuit, did refer to the decision of the lower Court in the case at bar, and said that his Court did not find it persuasive. The opinion in the *F. H. E.* case will, of course, be examined closely in the briefs of the parties in No. 26. In view of that fact, respondent here will make only the following brief observations:

(a) Whatever may be thought of the result, no one can dispute that the opinion is predicated on an erroneous understanding of the earlier statutes. For example, the statement is made that under the Revenue Act of 1924, 50% of the "net income from the property" was a limitation on *cost* depletion. This has never been the case under any of the revenue acts.

(b) The opinion assumes that the limitation provision originated in the 1924 Act; the fact is that it

first appeared in the Act of 1921. This oversight would seem to be important, especially in view of the fact that, contrary to the views expressed by this Court in the concluding sentence of *U. S. v. Dakota-Montana Oil Co.*, 288 U. S 459, the Fifth Circuit seemed to believe that the administrative and legislative history of "net income from the property" was of little, if any, consequence. As this Court said in the case just cited:

> "* * * these cases * * * did not consider the administrative and legislative history, which we think decisive."

V. Summary.

It is believed that this case may well be summarized by a series of questions directed to the Solicitor General, as follows:

1. It is true, is it not, that the Revenue Act of 1918 contained no limitation on depletion based upon "net income from the property"?

2. It is true, is it not, that the Treasury Regulations under the Revenue Act of 1918 (Art. 223, Regs. 45) gave taxpayers an option to deduct intangible drilling and development costs as an *operating* expense or to charge them to capital account returnable through depletion?

3. It is true, is it not, that under the Revenue Act of 1918 it made absolutely no difference whatever whether intangible drilling and development costs were described as *operating* expenses or *development* expenses?

4. It is true, is it not, that the phrase, "net income from the property," *first* originated in Section 234 (a) (9) of the Revenue Act of 1921?

5. It is true, is it not, that shortly after the enactment of the Revenue Act of 1921 the Bureau gave consideration to the meaning of "net income from the property" and reached the conclusion that it should be computed without regard to development costs and without regard to whether a particular taxpayer elected to deduct them in computing taxable income or to charge them to capital account? (See G. C. M. 2315, C. B. VI-2, p. 21.)

6. It is true, is it not, that in promulgating Art. 223 of Regs. 62 (under the 1921 Act) the Bureau changed its description of intangible drilling costs to *development* expense, as distinguished from *operating* expense?

7. It is true, is it not, that in Article 201 (h) of Regs. 62 the term "net income from the property" was defined as "the gross income from the sale of all mineral products and any other income incidental to the *operation* of the property for the production of the mineral products, less *operating* expenses, including depreciation on equipment, and taxes, but excluding any allowance for depletion"?

8. And it is true, is it not, that *development* costs, as defined in Art. 223 of Regs. 62, were not regarded by the Bureau as *operating* expenses within the meaning of Art. 201 (h)?

9. It is true, is it not, that when the Revenue Bill of 1924 was pending before Congress, A. W. Gregg, then Special Assistant to the Secretary of the Treasury, appeared and urged that the *limitation* on the discovery depletion allowance be reduced from 100% of the "*operating* profit from the property upon which the discovery is made" to 50% of the "operating profit"?

10. And it is true, is it not, that the report of the Senate Committee on Finance on the Revenue Bill of 1924 referred to the limitation on discovery depletion, that is, "net income from the property," as a percentage of "operating profit"?

11. It is true, is it not, that Art. 201 (h) of Regs. 65, under the 1924 Act, did not require the deduction of intangible development costs in arriving at "net income from the property"?

12. And it is true, is it not, that the Bureau, in administering the 1924 Act, as well as the 1921 Act, never contended that intangible drilling costs should be deducted in determining "net income from the property"?

13. It is true, is it not, that Judge Foster of the Fifth Circuit is utterly in error, in his opinion in the *F. H. E. Oil Company* case, when he says that under the Revenue Act of 1924 the limitation of 50% of the "net income from the property" was a limitation on *cost* depletion?

14. Is it not true that the limitation based on "net income from the property" has never, under any revenue law, been a limitation on *cost* depletion?

15. Is it not true that "net income from the property" was used, in the Revenue Acts of 1921 and 1924, as a limitation on *discovery* depletion and, in the 1926 and subsequent acts, as a limitation on *percentage* depletion?

16. Is it not true, as Judge Foster has said, that the Revenue Act of 1926 made a "radical change" as to the basis for computing depletion, when discovery depletion was abandoned and percentage depletion substituted therefor?

17. But is it not also true, that even in the face of this radical change, Congress saw fit to make no change in the *limiting* formula—that the same formula that operated to limit *discovery* depletion under the 1921 and 1924 Acts, was *retained* as a limitation on *percentage* depletion under the 1926 Act?

18. What evidence is there that Congress, in using the term, "net income from the property," in the 1926 or 1928 Acts, intended that phrase to be given a different meaning from that which the Treasury had given to identical language in the 1921 and 1924 Acts?

19. If, as you contend, the change in 1926 from discovery to percentage depletion required a different meaning to be given to the phrase, "net income from

the property," why is it that no such change was made in promulgating Regulations 69 (under the 1926 Act)? Why is it that Regs. 69 have never been amended?

20. Is it not true that many taxpayers, in connection with their income tax returns for the year 1925, made an election to deduct intangible drilling costs in determining taxable net income?

21. Is it not true that such election for 1925 requires such taxpayers to continue to deduct intangible development costs in "all subsequent years"—even down to the present time?

22. Is it not true that the *first* Treasury Regulation attempting to require the deduction of intangible development costs in arriving at "net income from the property" was Art. 221 (i) of Regs. 74?

23. Is it not true that this was not promulgated until February 15, 1929, and long after many taxpayers had made their election for 1925?

24. Is it not true that the Treasury has never, at any time since February 15, 1929, offered to release taxpayers from the binding effect—for all subsequent years—of the election made in connection with their returns for 1925?

25. Is it not true that if the Treasury had given notice of its attempt to change the definition of "net income from the property" *prior* to the exercise of

the option for the year 1925, many taxpayers might have elected to capitalize tangible development costs?

26. When the Treasury is still holding taxpayers to the effect of an election made for the year 1925, is it consonant with fair play to attempt to change the administrative construction which had been in effect for many years, which had been specifically brought to the attention of, and approved by, Congress in 1924, and upon the faith of which the taxpayer's election was made?

Conclusion.

The judgments of the Board of Tax Appeals and of the Court below should be affirmed.

Respectfully submitted,

JOSEPH D. BRADY,
Counsel for Respondent.

458 South Spring Street,
Los Angeles, California.

September 27, 1939.

APPENDIX.

G. C. M. 2315, C. B. VI-2, page 21:

An opinion is requested as to whether development expenditures made in connection with oil or gas wells should be deducted from the gross income of a discovery property in determining the net income from the property within the meaning of section 234 (a) 9 of the Revenue Act of 1921 where the taxpayer corporation, pursuant to article 223 of Regulations 62, elected to deduct such expenditures from its gross income in computing net income subject to Federal income or profits taxes.

Shortly after the enactment of the Revenue Act of 1921, the construction of the proviso inserted in section 234 (a) 9 of the Act that the "depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made" was given consideration by the Bureau, and the decision was reached that the "net income from the property" referred to in the proviso should be computed without regard to development expenditures, that is, that development expenditures should not be treated as a deduction in computing the "net income from the property" regardless of whether the taxpayer corporation under article 223 of Regulations 62 elected to treat such expenditures as operating expenses deductible in computing taxable income or to charge them to capital returnable through depletion. In view of the decision made at that time, the fact that it has been uniformly followed in closing a great number of cases, and the desirability of a consistent

administration of the provision in question, the conclusion is reached that in applying the limitation on discovery depletion in the case of oil and gas wells provided for in section 234 (a) 9 of the Revenue Act of 1921, the gross income from a discovery property should not be reduced by development expenditures in the computation of the "net income from the property," which amount measures the maximum depletion allowance based on discovery which can be allowed in respect to such property. A like construction should be followed in applying the provisions of section 214 (a) 10 of the Revenue Act of 1921 and the provisions of section 204 (c) of the Revenue Act of 1924. The latter section restricts a depletion allowance based on discovery value to "50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made."

The construction herein adopted relative to discovery depletion in the case of oil and gas wells under the 1921 and 1924 Acts should be confined to those Acts. Under section 204 (c) 2 of the Revenue Act of 1926, provision is made that in the case of oil and gas wells the allowance for depletion based upon the gross income from the property "shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property." The term "net income" as used in that section should be taken to mean the net income defined in sections 212 and 232 of the Act. Accordingly, if a taxpayer elects to treat development expenditures as ordinary and necessary business ex-

penses deductible under section 214 (a) 1 or 234 (a) 1 in computing taxable net income, such expenditures must be deducted in determining the net income from the property, which amount is used as a limitation in the computation of the depletion allowance based on income.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

S. Rep. No. 960, 70th Cong., First Sess., p. 20:

"Sec. 23(k) and (l) Depreciation and Depletion—Life Estates and Trusts—The House *bill makes no change in existing law* with respect to these deductions. The Committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship *in these two classes of cases* under the existing law.

In the case of life tenant and remainderman the bill provides that deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property * * * In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the will. * * * The bill contains similar provisions as to deductions for depletion."

H. Rep. No. 1882, 70th Cong., First Sess., p. 11:

"Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction shall be considered as the absolute owner; * * * in the case of property held in trust the allowable deduction is to be apportioned between the income beneficiary and the trustee in accordance with the pertinent provisions of the will. * * * The bill contains similar provisions as to deduction for depletion. The Senate amendment provides for an equitable apportionment in the deduction of this case. And the House recedes.

"Amendments Nos. 31 and 32. The purpose and effect of these amendments, which relate to the deduction for depletion in the case of property held by one person and remainder to another person, and in the case of property held in trust, is similar in effect to amendment No. 30. And the House recedes."

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IN THE

SUPREME COURT
OF THE
UNITED STATES.

OCTOBER TERM, 1939.

No. 1.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

WILSHIRE OIL COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

RESPONDENT'S PETITION FOR REHEARING.

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Parker & Baird Company, Law Printers, Los Angeles.

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RESPONDENT'S PETITION FOR REHEARING.

Respondent respectfully shows:

1. Mr. Justice Douglas delivered the opinion of this Court on November 6, 1939. Time for filing this petition was extended to December 9, 1939.

2. Respondent will not seek herein to argue against the wisdom of this Court's broad approval of the Commissioner's contention (Petitioner's Brief, p. 19) that where earlier regulations have been issued under identical statutory provisions, and where such regulations have unambiguously covered the situation, then nevertheless the

Commissioner is empowered to issue different regulations under a later statute *provided* such new regulations operate *with prospective effect only.*

3. Respondent does respectfully urge, however, that this Court's determination that the regulations did not apply with retroactive effect upon the respondent was due to the circumstance that this Court was not fully aware of the facts and their proper significance.

4. The rationale of decision appears to be that the regulations in question did not affect respondent retroactively because (a) respondent "was afforded ample opportunity to make a new election"; (b) "there is no reasonable basis for concluding that when respondent made its second election in 1927 it had no basis for assuming that the policy * * * was or would be no different"; and (c) that "in terms of equitable considerations respondent has no just ground of complaint" (Opinion, pp. 5, 6). These conclusions were in turn based upon the premise that G. C. M. 2315, released on September 26, 1927, so modified and enlarged the scope of the election afforded by Treasury Decision 4025, dated June 18, 1927 (which decision "contained no notice of any projected change"), as to include within the scope of such election a regulation which is diametrically opposed to that then in effect and which was not promulgated *in the manner required by the statute or at all* until fourteen months after the opportunity to elect had expired. The premise upon which the conclusions are based, we respectfully submit, is untenable either logically or factually.

We believe this Court, when it arrived at its decision, was, very excusably, not fully aware of one extremely important fact not shown in the printed record and disclosed

by the Commissioner for the first time only after oral argument for the respondent had been concluded. We refer to the letter addressed to the Solicitor General by the Commissioner, dated October 6, 1939, which this Court permitted the Commissioner to file at the oral argument. The language of its opinion herein shows that this Court overlooked the statement in the Commissioner's letter that G. C. M. 2315 (not promulgated until September 26, 1927) was actually in existence on May 27, 1927—22 days *prior* to the issuance of T. D. 4025. From this indisputable fact only one conclusion may be fairly drawn: when the Commissioner, with approval of the Secretary, promulgated T. D. 4025 on June 18, 1927, without any mention therein of any proposed change in the regulations, those authorized officials thereby placed the stamp of disapproval upon the possible change attempted to be "foreshadowed" by the General Counsel's Memorandum. We reject, and believe this Court will reject, the possible but unwarranted alternative conclusion that the Commissioner and Secretary, when T. D. 4025 was released, contemplated a change in the regulations but deliberately concealed that intention from taxpayers in the hope that taxpayers would allow the period within which a different option might be made to elapse without taking action.

We also believe that this Court, when it arrived at its conclusion, was not fully aware of the following pertinent facts: (a) no reasonably prudent man who had determined upon a negative course of action in June, 1927, after fully considering the terms of and the basis for the new election offered by T. D. 4025, would consider, upon reading G. C. M. 2315 some three or four months later—if indeed he read it at all—that such memorandum in any way re-

quired a reconsideration of his decision in connection with the option; (b) in a great many cases it would be a physical impossibility for a taxpayer to file the two amended returns required by T. D. 4025 in the short period of time between September 26th and December 18th, 1927. The Commissioner evidently considered that six months was necessary for a taxpayer to prepare amended returns for two years.

The foregoing facts become pertinent only if it is assumed (1) that all taxpayers are required to subscribe to some tax service or other means of obtaining General Counsel's Memoranda "hot off the press" (the Cumulative Bulletin containing G. C. M. 2315 was not printed until 1928, *after* the period within which the taxpayer might have made a new election had already expired); (2) that taxpayers, as a matter of law, are put on notice that rules and regulations, required by Congress to be approved by the Secretary, Sec. 23(1) of the Revenue Act of 1928, may be modified by a General Counsel's Memorandum, not approved by the Commissioner or the Secretary; and (3) that taxpayers must act today with reference to possible changes in administrative policy "foreshadowed" in a General Counsel's Memorandum released some seventeen months before the change in policy is adopted by the only two officials authorized by Congress to make rules and regulations.

This taxpayer also had every right to rely upon the fact that it has been the established legislative policy of Congress, and, until this case arose, the established admin-

istrative policy of the Commissioner and Secretary, to grant new elections to taxpayers when there occurred a change in the law or the regulations, respectively, with reference to which the taxpayer had theretofore entered into a binding election covering future years. This established policy is illustrated by Treasury Decision 4025 itself and also by the history of the capital stock and complementary excess-profits tax statutes. Congress has even gone further and expressly provided, in certain instances, that where an election is provided for by statute, the tax payer is bound *only* by the regulation "prescribed *prior* to the making of such return." Cf. Sec. 141 (a) of the Revenue Act of 1928; Sec. 215(a) (9) (B) of the Revenue Act of 1939. These specific examples show that, in the Congressional mind, taxpayers, bound by a prior election, are entitled to a new one even though prospective, but different, regulations prescribed after the first election was made, do "not purport to reach back to earlier years" (Opinion, p. 4).

Where a taxpayer has made an election pursuant to permission granted by the Regulations, this Court has likened the legal effect of such action to the contractual relationship. See *Ilfeld v. Hernandez*, 292 U. S. 62, 65. But respondent does not ask this Court to go so far in this case. Respondent does not urge the adoption of the contract theory with all of its possible impairment of the administrative process. It has now been determined by the opinion herein that the Commissioner may issue *pros-*

pective regulations which are not in harmony with prior regulations under identical prior statutes. It is undoubtedly true that "experience, changing needs, changing philosophies inevitably produce constant change" (Opinion, p. 4). That fact, however, need never clash with principles of fair dealing. Nor does that conclusion require that a taxpayer, who has made an election in reliance upon the then existing practice, be foreclosed from the opportunity to make a new election when the Commissioner determines to issue new regulations which adversely affect the taxpayer. Nor can the granting of such a new election possibly cause the administrative process to bog down. We are confident that this Court will not accept a contrary view, from which it would necessarily follow, that a taxpayer must never bind himself, by making an election, without full realization of the fact that while the hands of agreement are still moist from the contact of understanding, there may fall the "black-jack" of "changed rules" from which he has no escape. This Court will not cast upon the Department a stigma arising from the inference that the bludgeon of G. C. M. 2315 was actually raised in departmental hands when the obviously fair new election contained in T. D. 4025, which gave no notice of any projected change, was proffered.

In fairness to the Commissioner and Secretary, we must record our conviction that at no time did those officials entertain the thought that T. D. 4025, released on June 18, 1927, should be construed so as to constitute an

offer of a new election in connection with Treasury Regulations not to be promulgated until some twenty months later.

We believe the Treasury in turn will admit that the ability to offer taxpayers alternative methods of treatment in border-line cases, the choice of which depends upon ever-changing circumstances, contributes as much as any other factor to the elasticity, speeding up and effectiveness of the administrative process. A decision adverse to the position of the respondent in this case will unnecessarily restrict this essential administrative requirement. Unless respondent's position is sustained, few taxpayers will adopt in the future a course of action to which they are permanently bound when faced with the knowledge that without an opportunity to make a new election, their tax obligations may be enormously increased. We also believe that the Treasury will admit that no decrease in effectiveness or adaptability will result to the administrative process if the taxpayer is given the right to make a new election where the Regulations are changed in such manner as to work unforeseeable hardship upon the taxpayer.

We therefore earnestly request this Court to determine (a) that where regulations with reference to which a taxpayer has made a binding election are subsequently changed in such manner as adversely to affect him, such taxpayer is entitled to an opportunity to make a new election; and (b) that in this case no such opportunity to make a new election was afforded the respondent. We

further earnestly represent that such a determination will redound to the benefit of the public good in such measure as to make infinitesimal the possible tax liability involved in this case.

Wherefore, with profound respect for the judgment of this Court, it is respectfully urged that this petition for a rehearing be granted, and that the judgment of the Circuit Court of Appeals for the Ninth Circuit be, upon further consideration, affirmed.

Respectfully submitted,

JOSEPH D. BRADY,
Counsel for Respondent,
458 South Spring Street,
Los Angeles, California.

Of Counsel:
EDGAR LEWIS.

November 30, 1939.

Certificate of Counsel.

I, Joseph D. Brady, counsel for the above-named respondent, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

JOSEPH D. BRADY,
Counsel for Respondent.

PP. 3,5,.

SUPREME COURT OF THE UNITED STATES.

No. 1.—October Term, 1939.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Wilshire Oil Company, Inc.	On Writ of Certiorari to United States Circuit Court of Appeals, Ninth Circuit.

[November 6, 1939.]

Mr. Justice Douglas delivered the opinion of the Court.

This case presents the question whether respondent, Wilshire Oil Company, Inc., in computing its net income for the years 1929 and 1930 for the purpose of applying the 50 per cent limitation on depletion allowance under § 114(b)(3) of the Revenue Act of 1928 (45 Stat. 791), may refuse to take as deductions certain development expenditures,[1] where it has deducted those development expenditures in computing its taxable net income for those years. The Board of Tax Appeals held for the respondent (35 B. T. A. 450) and that decision was affirmed by the Circuit Court of Appeals, one judge dissenting (95 F. (2d) 971). Because of the importance of the problem of the scope of the Commissioner's rule-making power and because of an asserted conflict of the decision below with the decision of the Circuit Court of Appeals for the Fifth Circuit in *Commissioner of Internal Revenue* v. *F. H. E. Oil Co.*, 102 F. (2d) 596, we granted certiorari.

Respondent is engaged in the business of producing oil and gas from its various properties. In computing taxable net income in its returns for 1929 and 1930 respondent, pursuant to the regulations, deducted development expenditures in the respective amounts of $606,051.66 and $279,927.04. But it refused to make those deductions in determining its "net income . . . from the property"

[1] These expenditures consisted of such items as labor, fuel and power, materials and supplies, tool rental, truck and auto hire, repairs to drilling equipment and depreciation upon equipment used in drilling.

for the same years, when computing allowable depletion under § 114(b)(3) of the Revenue Act of 1928.[2]

That section provides:

"In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

By virtue of § 23 of the Revenue Act of 1928 companies like respondent were allowed as deductions in computing net income a "reasonable allowance for depletion . . . according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary." Pursuant to that rule-making power the phrase "net income of the taxpayer (computed without allowance for depletion)" as used in § 114(b)(3) was defined by Treasury Regula-

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[2] For the year 1929 the Commissioner's computations were as follows:

Gross Income from the properties		$1,001,375.17
Deductions: Production expense	$171,399.03	
Development expense	606,051.66	
Total expenses		777,450.69
Net income from property (computed without allowance for depletion)		$223,924.48
50 percent of that income		$111,962.24

The Commissioner limited the depletion allowance to the last mentioned figure since 50 per cent of the net income from the property as thus computed was less than 27½ per cent of the gross income.

Under the taxpayers computation, the net income for depletion purposes would be $1,001,375.17 less $171,399.03 or $829,976.14 and 50 per cent thereof would not be less than 27½ per cent of the gross income.

For the year 1930 the Commissioner's computation showed a loss of $194,869.22. He therefore ruled that since the percentage depletion allowance was limited to 50 per cent of the net income from the properties and since the taxpayer had no such net income, no deduction on account of percentage depletion could be allowed. The taxpayer refused, however, to deduct development expenses in the application of the 50 per cent limitation and claimed a depletion deduction of $42,528.91, arrived at as follows:

Gross income from the properties	$370,448.72
Deductions: Production expense	285,390.90
Net Income	$85,057.82
Depletion deduction (50 per cent of net income)	$42,528.91

tions 74, Art. 221(i) promulgated under the 1928 Act as meaning "gross income from the sale of oil and gas" less certain deductions including "development expenses (if the taxpayer has elected to deduct development expenses) . . . but excluding any allowance for depletion". For 1925 respondent, having the option to treat these expenses as deductions for development expenses or as charges to the capital account returnable through depletion,[3] chose the former.

On these facts it would seem that Treasury Regulations 74, Art. 221(i) would require respondent to deduct development expenses in computing "net income" as used in § 114(b)(3), since respondent fell clearly within the class described therein.

But respondent contends that these regulations as applied to it for the taxable years in question are invalid. Its argument runs as follows: (1) The phrase "net income . . . from the property" present in § 114(b)(3) originated in § 234(a)(9) of the Revenue Act of 1921 (42 Stat. 227) and was reenacted without change in § 204(c) of the 1924 Act (43 Stat. 253). It was also carried over into § 204(c)(2) of the 1926 Act (44 Stat. 9), when Congress adopted the present so-called percentage depletion formula. Shortly after the enactment of the Revenue Act of 1921, Treasury Regulations were issued defining net income . . . from the property" as meaning gross income from the property less "operating expenses".[4] A similar definition was given in the Treasury Regulations issued under the Revenue Act of 1924.[5] The admitted Treasury practice under those two Acts was to permit net income from the property to be computed without regard to development expenditures. Hence, respondent argues, the meaning of the phrase "net income . . . from the property" had acquired a plain and definite meaning, known to the Congress; thus when that phrase was reenacted in the 1924 Act, the Congress intended it to have the meaning which administrative practice had given it. And, the argument continues, that meaning having been adopted by the Congress in the 1924 Act, it clung to the same phrase in the

[3] Treasury Regulations 69, Art. 223, promulgated under the Revenue Act of 1926 provides that "such incidental expenses as are paid for . . . development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. . . . An election once made under the provisions of this article will control the taxpayer's returns for all subsequent years."

[4] Treasury Regulations 62, Art. 201(h).

[5] Treasury Regulations 65, Art. 201(h).

1926 Act[6] and in the 1928 Act, especially since the Commissioner prior to February 15, 1929[7] never did undertake by regulation or decision to give that phrase a meaning different from that which had been consistently applied under the earlier Acts.

(2) Secondly, respondent contends that the fact that it deducted development expenses in computing taxable net income does not mean that it is required to make the same deductions for the "net income" computation under § 114(b)(3) for the reason that it had no free choice in the first of these computations. In that connection it points out that it was required to make these deductions from gross income by reason of its election in its 1925 return to treat these expenses as deductions for development expenses rather than as charges to capital account returnable through depletion, an election binding for all subsequent years. In that posture of the case it argues that the attempted change in the regulations here involved has a retroactive effect, as applied to it, and withdraws one of the important inducements offered by the Commissioner in connection with the election which respondent made in its 1925 return.

We do not think that respondent's position is tenable.

As to respondent's claim of retroactivity, it is true that the election made in connection with its 1925 return was known to be binding for all subsequent years. It is likewise true that it was made at a time when Treasury practice did not require deduction of development expenses in making the computation under § 114(b)(3). But that is no basis for a claim of retroactivity. Treasury Regulations 74, Art. 221(i) which required the deduction of development expenses for the purpose of the computation under § 114(b)(3) were issued February 15, 1929 under the 1928 Act. These regulations applied prospectively only and did not purport to reach back to earlier years when the taxpayer relied on a different rule or practice. Tax statutes and tax regulations never have been static. Experience, changing needs, changing philosophies inevitably produce constant change in each. One making an elec-

[6] Respondent points to the Report of Committee on Ways and Means on Revenue Bill of 1926 (H. Rep. No. 1, 69th Cong., 1st Sess., p. 6): "The discovery depletion deduction limitation of an amount not in excess of 50 per cent of the net income of the taxpayer from the property upon which discovery was made, provided in existing law, is retained in this provision."

[7] The date when Treasury Regulations 74, Art. 221(i), here in question, were promulgated.

tion in the 1925 return took the risk that the method of treatment of depletion might be changed by the Congress, or, where power existed, by the Commissioner. Any other conclusion would make the application of changes pursuant to regulations, though prospective, dependent on fortuitous circumstances under which each taxpayer made such an election. Rigidity, as well as confusion, in administration of tax laws would be the result.

But in this case there is another answer to respondent's claim that an inequity results by changing the regulations after it had made its election in the 1925 return. On June 18, 1927, the Commissioner, with the approval of the Secretary, issued a Treasury Decision[8] stating that "In view of the change in the basis for depletion provided by the Revenue Act of 1926, in the case of oil and gas wells, taxpayers may make a new election as to the treatment" of development expenditures "for taxable periods ending on or after January 1, 1925, but not later than six months after the date of this decision." Taxpayers desiring to make a new election were required to file amended returns for the taxable periods involved within six months from the date of that decision. Thus respondent, after Congress adopted the new percentage depletion provision, was afforded ample opportunity to make a new election. This it did not do. To be sure that Treasury Decision contained no notice of any projected change in the meaning of "net income . . . from property" as used in § 114(b)(3). But in September 1927 there issued a General Counsel's Memorandum[9] in which it was stated that thereafter "if a taxpayer elects to treat development expenditures as ordinary and necessary business expenses . . . . in computing taxable net income, such expenditures must be deducted in determining the net income from the property, which amount is used as a limitation in computation of the depletion allowance based on income". To be sure this was merely an opinion of the General Counsel of the Bureau and did not have the force or effect of a Treasury Decision. Yet in view of such ruling, there is now no reasonable basis for concluding that when respondent made its second election in 1927 it had no basis for assuming that the policy as respects "net income . . . from the property" under the 1926 Act was or would be no different than it had been under the 1921 and

[8] Treasury Decision 4025, Cum. Bul. VI-1, p. 75.
[9] G. C. M. 2315, Cum. Bul. VI-2, p. 21.

1924 Acts. Therefore, in terms of equitable considerations respondent has no just ground of complaint. On these facts substantial justice requires that respondent take such burdens as may flow from its election along with the benefits.

Irrespective of these considerations, we think the regulations in question were valid. It is true, as stated by respondent, that the regulations under the 1921 Act provided that the "net income . . . from the property" should be computed for purpose of the depletion allowance without regard to development expenditures. And it may be assumed that that administrative construction received legislative approval by the reenactment of the statutory provision in the 1924 Act, without material change. Cf. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466. But that does not mean that that meaning survived both the 1926 and the 1928 Acts. In the first place, there were no comparable regulations under the 1926 Act.[10] In fact, the Commissioner undertook under that Act to follow the practice later set forth in the regulations here in question. See *Ambassador Petroleum Co.* v. *Commissioner*, 81 F. (2d) 474. Those facts are of some significance here for they refute the suggestion that the Congress in enacting the 1928 Act was giving approval to an administrative construction which had been given to comparable provisions of earlier Acts but which was abandoned before the passage of the 1928 Act. The more reasonable inference seems to be that reenactment of the provision in question by the 1928 Act at a time when Treasury policy as respects its construction had changed did nothing more than to restore to the phrase "net income . . . from the property" its original ambiguity.

[10] As respects discovery depletion in the case of mines under the 1926 Act, provisions similar to those under the 1921 and 1924 Acts were retained. Treasury Regulations 69, Art. 204(h). But this was not true as respects oil and gas wells. § 204(c)(2) of the Revenue Act of 1926 applied the percentage depletion allowance exclusively to "oil and gas wells". Treasury Regulations 69, Art. 221, provided:

"Under section 204(c)(2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, 'the property,' as the term is used in section 204(c)(2) and this article, refers to the separate tracts or leases of the taxpayer."

Thus, it is apparent that the delimitation implied in the permission to deduct "operating expenses" present under the earlier regulations disappeared from the 1926 regulations in case of oil and gas wells.

Accordingly that phrase became peculiarly susceptible to new administrative interpretation. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110; *Morrissey* v. *Commissioner of Internal Revenue*, 296 U. S. 344.

But in any event, the validity of the regulations in question seems clear. The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States* v. *Dakota-Montana Oil Co.*, *supra*) covers the situation where the validity of administrative action standing by itself may be dubious or where ambiguities in a statute or rules are resolved by reference to administrative practice prior to reenactment of a statute; and where it does not appear that the rule or practice has been changed by the administrative agency through exercise of its continuing rule-making power. It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers. Cf. *Morrissey* v. *Commissioner of Internal Revenue*, *supra*, at p. 355. The contrary conclusion would not only drastically curtail the scope and materially impair the flexibility of administrative action; it would produce a most awkward situation. Outstanding regulations which had survived one Act could be changed only after a pre-view by the Congress. In preparation for a new revenue Act the Commissioner would have to prepare in advance new regulations covering old provisions. Their effectiveness would have to await Congressional approval of the new Act. The effect of such procedure, so far as time is concerned, would be precisely the same as if these new regulations were submitted to the Congress for approval. Such dilution of administrative powers would deprive the administrative process of some of its most valuable qualities—ease of adjustment to change, flexibility in light of experience, swiftness in meeting new or emergency situations. It would make the administrative process under these circumstances cumbersome and slow. Known inequities in existing regulations would have to await the advent of a new revenue act. Paralysis in effort to keep abreast of changes in business practices and new conditions would redound at times to the detriment of the revenue; at times to the disadvantage of the taxpayer. Likewise the result would be to read into the grant of express administrative powers an implied condition that they were not to be exer-

cised unless, in effect, the Congress had consented. We do not believe that such impairment of the administrative process is consistent with the statutory scheme which the Congress has designed.

The only remaining question is whether Treasury Regulations 74, Art. 221(i) were within the power of the Commissioner to promulgate. That they were seems clear beyond question. We are not dealing here, as was this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, *supra*, with regulations applied retroactively. These are applied prospectively only. The rule-making power here in question may be found in § 23(l) of the Revenue Act of 1928. That section, after providing that companies like respondent were entitled, as a deduction in computing net income, to a "reasonable allowance for depletion . . . according to the peculiar conditions in each case" laid especial emphasis on the power of the Commissioner to make rules for the computation of the depletion allowance, by providing that "such reasonable allowance in all cases is to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary".

Respondent does not strongly urge that the regulatory power conferred by § 23(l) does not extend to the percentage depletion allowance under § 114(b)(3). Rather the contention seems to be that to allow the Commissioner by regulation to change the measure of "net income . . . from the property" from time to time, especially in the manner here attempted, would be to approve a result equally as contrary to the intention of Congress as if he had attempted by regulation to change the percentage factors themselves. But the scope or importance of the change effected by the regulations is immaterial if the power to promulgate such regulations exists. Here the Congress has not prescribed a precise formula free from all ambiguity. The ambiguous phrase "net income . . . from the property" was susceptible of various meanings and hence administrative interpretation of it was peculiarly appropriate, as we have said. And there were special reasons growing out of the complex nature of the depletion problem as it is treated for purposes of the income tax, for requiring the Commissioner to make precise the vague elements of that formula. In its general aspects under revenue acts depletion is a problem on which taxpayers, government and accountants have expressed a contrariety of opinions.[11] Obfuscation in attempted application of its princi-

[11] 2 Paul & Mertens, The Law of Federal Income Taxation (1934), ch. 21; 47 Yale L. Journ. 806 (1938).

ples under income tax laws has frequently been the result. The Congress itself, as revealed in the history of the revenue acts, has expressed varying philosophies. In practical administration of any one statute there are admittedly borderline cases between deductible business expenses and non-deductible capital outlays. On specific fact situations the clear line between depletion, depreciation, and obsolescence often becomes blurred.[12] What those lines are or should be is for the Congress and the Commissioner. Experience and new insight can be expected to produce rather constant change. In sum, the highly technical and involved factors entering into a practical solution of the problem of depletion in administration of the tax laws points to the necessity of interpreting § 23(l) so as to strengthen rather than to weaken the administrative powers to deal with it equitably and reasonably. These considerations are persuasive here not only in reaffirming the conclusion that the rule-making power existed, but also in concluding that restrictions on that power should not be lightly imposed where the incidence of such rules as are promulgated is prospective only.

Reversed.

Mr. Justice BUTLER and Mr. Justice REED took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

[12] See for example the issues posed in United States *v.* Dakota-Montana Oil Co., *supra*.